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The Economics of the New Unemployment

Martin Feldstein

On Managing the Public Service Institution

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How Congress Can Cope with the Budget — *Aaron Wildavsky*

On Economic Justice: An Exchange — *Richard A. Posner / Lester C. Thurow*

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The economics of the new unemployment

MARTIN FELDSTEIN

A HIGH level of unemployment is a persistent problem of the American economy. During the past 20 years, the average rate of unemployment exceeded 4.5 per cent. In only one post-War year (1953) did unemployment drop below three per cent. Although every segment of society is affected, some groups have unemployment rates that are several times as high as the national average. At the end of the first half of 1972, more than nine per cent of the non-white labor force was unemployed. Among men under 25, the unemployment rate was 11.5 per cent. These high unemployment rates imply substantial personal and aggregate losses. Moreover, as I shall emphasize below, the American pattern of unemployment is a symptom of a more serious failure in the development and use of our nation's manpower.

Unfortunately, there is no reason to expect that the next 20 years will be better than the last. Without substantial new policy initiatives, American unemployment rates will remain significantly higher than those that prevail in Western Europe and in most other industrial nations. Now that unemployment has fallen from the very high rates of 1970 and 1971, it is important to ask whether there is anything that can be done to lower permanently the average rate of unemployment to three per cent or below.

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I recently examined this question in a study prepared for the Joint Economic Committee of the U.S. Congress.[1] Although my conclusions and proposals should be regarded as tentative, I believe that it is important to stimulate discussion about these issues at the current time. The basic conclusions of my study can be summarized briefly:

First, I believe that we probably can lower the permanent unemployment rate to a level substantially below the average of the post-War period. An average unemployment rate significantly less than three per cent, and possibly close to two per cent, for those seeking steady full-time employment is a realistic goal for the next decade.

Second, the economy is not likely to achieve such a goal, or indeed to perform any better than it did in the past two decades, without significant changes in employment policy.

Third, expansionary macroeconomic policy cannot be relied upon to achieve the desired reduction in unemployment. Any possible increase in aggregate demand that does not have unacceptable effects on the rate of inflation would leave a high residue of unemployment. I believe that this is true even if one is very optimistic about the effect of increases in aggregate demand on inflation. The structure of unemployment and the current functioning of our labor markets imply a high overall rate of unemployment even when certain key unemployment rates are extremely low. Better management of aggregate demand has a role to play, but it cannot do the entire job.

Fourth, lowering the overall rate of unemployment will require new types of policies aimed at increasing the stability of employment among young workers, at eliminating unnecessary seasonal and cyclical fluctuations in labor demand, and at increasing the speed with which the unemployed return to work. Several such policies are suggested below.

I. The limited efficacy of increasing demand

Most macroeconomic analyses of unemployment are based on ideas about the causes and structure of unemployment that are

[1] See Martin Feldstein, *Lowering the Permanent Rate of Unemployment,* A Joint Committee Print of the Joint Economic Committee (Washington, Government Printing Office, 1973). See also the hearings of the Joint Economic Committee published as *Reducing Unemployment to 2 Percent,* Hearings before the Joint Committee, October 17, 18, and 26, 1972 (Washington, Government Printing Office, 1972).

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inappropriate and out of date. The basic framework of Keynesian economics, conditioned by the experience of the 1930's, has always emphasized the inadequacy of aggregate demand as the source of unemployment. The conventional view of post-War unemployment might be described as follows: "The growth of demand for goods and services does not always keep pace with the expansion of the labor force and the rise in output per man. Firms therefore lay off employees and fail to hire new members of the labor force at a sufficient rate. The result is a pool of potential workers who are unable to find jobs. Only policies to increase the growth of demand can create the jobs needed to absorb the unemployed."

This picture of a hard core of unemployed workers who are not able to find jobs is an inaccurate description of our economy and a misleading basis for policy. A more accurate description is an active labor market in which almost everyone who is out of work can find his usual type of job in a relatively short time. *The problem is not that these jobs are unavailable but that they are often unattractive.* Much of the unemployment and even more of the lost manpower occurs among individuals who find that the available jobs are neither appealing in themselves nor rewarding as pathways to better jobs in the future. For such individuals, job attachment is weak, quitting is common, and periods without work or active job seeking are frequent. *The major problem to be dealt with is not a chronic aggregate shortage of jobs but the instability of individual employment.* Decreasing the overall rate of unemployment requires not merely more jobs, but new incentives to encourage those who are out of work to seek employment more actively and those who are employed to remain at work. As I shall explain below, an important part of these incentives is a change in the kinds of jobs that are available.

It is difficult to replace our old notions about demand-determined unemployment by this new view. Let me therefore describe in more detail some of the characteristics of American unemployment during the past decade. I will begin with the experience of the total labor force and then consider differences among demographic groups.

First, the duration of unemployment is quite short. Even in a year like 1971 with a very high unemployment rate, 45 per cent of those unemployed had been out of work for less than five weeks. In 1969, this proportion was almost 58 per cent. Similarly, very few are without jobs for as long as 27 weeks; in 1969 this was 4.7 per cent and in 1971 it was 10.4 per cent of all the unemployed.

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Second, loss of jobs accounts for less than half of total unemployment. In 1971, only 46 per cent of the unemployed had lost their previous jobs. In the more favorable market conditions of 1969, this proportion was only 36 per cent. The remainder are those who voluntarily left their last jobs, are reentering the labor force, or never worked before. In 1969, with an overall unemployment rate of 3.5 per cent, losing one's job contributed only 1.2 per cent to this figure.

Third, the turnover of jobs is extremely high. Data collected from manufacturing establishments show that total hirings and separations have each exceeded four per cent of the labor force per month since 1960. Moreover, the number of quits has consistently exceeded layoffs during the past five years. Even with the high unemployment of 1971, more workers quit manufacturing jobs than were laid off.

A comparison of these figures with corresponding data for Great Britain indicates that the British achieve a generally lower unemployment rate partly by having a very different structure of unemployment.[2] During the 1960's, Britain's average unemployment rate (as adjusted by the U.S. Department of Labor to the U.S. definition) was only 2.7 per cent. The structure of British unemployment corresponds more closely to the traditional picture of cyclically inadequate demand, chronic structural unemployment in particular regions, and a very low level of "frictional" job search. Despite the lower overall unemployment rate, British durations of unemployment are much longer. While 13.6 per cent of unemployed men were out of work for 27 weeks or more in the United States in 1971, in Britain the corresponding figure was 23.8 per cent in a recent period of high unemployment (April 1969). Similarly, while only five eighths of American unemployed men were out more than five weeks, in Britain the same fraction of men was out more than eight weeks. This longer duration is compatible with a much lower overall unemployment rate only because many fewer men become unemployed in the first place. One indication of this is that British turnover rates are approximately half of U.S. levels. Britain achieves a low unemployment rate by completely avoiding much of the short-term unemployment that prevails in the United States. Some of the specific ways in which this will be examined later in this article.

[2] A study of the British experience is particularly useful because Britain, unlike some other European countries, does not maintain full employment for its own labor force by permitting temporary immigration of foreign laborers.

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Demographic differences

Perhaps the most important characteristic of our current unemployment problem is the differences in unemployment experience among demographic groups. The unemployment rates in certain groups are not only very high but are also quite unresponsive to changes in the aggregate demand for labor. This implies that fiscal and monetary policies that drastically cut the unemployment rate of mature men would still leave a high overall unemployment rate.

To study these differences I have estimated the relation between the unemployment rate in each demographic group and the concurrent unemployment rate for men over 24 years of age. This rate for mature men provides one of the best measures of cyclical variation in labor market pressure. Table 1 presents the results of this analysis. Column I gives the 1971 unemployment rates in eight different demographic groups, ranging from four per cent for white men to 32 per cent for non-white teenagers. Column II shows the sensitivity of each unemployment rate to labor market pressure (i.e., the change in that specific unemployment rate that would occur when the rate for men over 24 years of age changes by one per cent). For example, a one per cent fall in the unemployment rate for mature men would lower the teenage male unemployment rate by about 1.5 per cent. A change in aggregate demand, therefore, has a greater absolute effect on the teenage unemployment rate than on the rate for mature men. Nevertheless, variations in aggregate demand account for a relatively small fraction of the high level of teenage male unemployment. Even if the rate for mature men were depressed to 1.5 per cent—below the level reached at any time in the post-War period—the analysis implies

TABLE 1. *Differences in Unemployment Experience Among Demographic Groups*

Demographic Group	I Unemployment Rate, 1971	II Sensitivity to Rate of Mature Men[1]	III Unemployment Rate When Mature Men[1] Unemployment is 1.5 Per Cent
Males, 16-19	16.7	1.45	11.4
Females, 16-19	17.4	0.26	13.7
Whites, 16-19	15.2	1.03	10.8
Non-whites, 16-19	31.8	0.26	24.5
Males, white, 20+	4.0	0.92	1.7
Males, non-white, 20+	7.3	2.33	3.3
Females, white, 20+	5.3	0.59	3.2
Females, non-white, 20+	8.7	0.99	6.1

[1] The mature men unemployment rate refers to all men over age 24.

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that the male teenage rate would be at about 11.4 per cent. This is shown in Column III. Although the absolute sensitivity of male teenage unemployment to changes in aggregate demand is a serious problem, it is the very high level of the cyclical troughs that prevents macroeconomic policy from reducing that unemployment to a level below five per cent.

The figures reported in Table 1 indicate that overall unemployment would remain high even in a very tight labor market, but they do not explain why individual unemployment rates behave so differently. Some understanding of this at a relatively crude empirical level can be obtained by examining the proportions of the unemployed in different demographic groups who are job leavers, job losers, new entrants, and reentrants.

Table 2 shows that the primary difference in the structure of unemployment for mature males and for mature females is the higher unemployment rate for women among those who are reentrants to the labor force. Unfortunately, the term "reentrant" is unclear. It includes not only women who return to the labor force after caring for a family for a number of years, but also those who are seeking work after a brief period of voluntary withdrawal from the labor force. This component of the higher unemployment rate of women probably represents both the natural frictional unemployment at a second entry into the labor market and the result of a weaker attachment to employment on the part of some women who move temporarily in and out of the labor force. The higher rate of women's unemployment due to job leaving provides support for this view of weaker labor force attachment.

Although teenagers have a slightly higher and more cyclical rate of unemployment due to job loss, the much higher teenage unemployment rates are clearly due to the high rate for new entrants, reentrants, and job leavers. Although these components are also cyclically sensitive, they remain very high even in a year with a

TABLE 2. *Composition of Unemployment by Demographic Groups, 1971*

	All Unemployed	Male 20+	Female 20+	Both Sexes 16–19	Non-Whites
Total Unemployment Rate	5.9	4.4	5.7	16.9	9.9
Per cent Distribution					
Lost last job	46.3	66.3	42.2	18.5	42.4
Left last job	11.8	11.4	14.2	9.2	11.2
Reentered labor force	29.4	19.6	39.3	32.5	31.6
Never worked before	12.5	2.7	4.3	39.8	14.8

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tight labor market. I shall return to discuss this more fully in the next section.

Finally, non-white unemployment rates are higher in every category, but again job loss acounts for less than half of total unemployment. Even though non-whites have more difficulty in finding employment, unemployment due to voluntary separations and withdrawals from the labor force is approximately twice the level for whites.

The evidence presented in this section can be summarized briefly: *The current structure of unemployment in the American economy is not compatible with the traditional view of a hard core of unemployed who are unable to find jobs.* Even with the high unemployment rate of 1971, the durations of unemployment were short, job losers accounted for less than half of unemployment, and quit rates generally exceeded layoffs. An examination of the past experience of individual demographic groups indicates very substantial variation in the response of unemployment rates to aggregate demand and implies that even an extremely tight labor market would leave some groups with high unemployment rates. The next three sections examine why these unemployment rates are not more sensitive to aggregate demand and suggest possible policies to deal with these problems.

II. Unemployment among young workers

Unemployment rates for young persons seem outrageously high. In 1971, male teenagers had an unemployment rate of 16.6 per cent. Even among those aged 20 through 24, the unemployment rate was 10.3 per cent. If unemployment in these groups could be reduced to the same rate as for mature men, the overall rate would fall by more than one third.

Similar results are obtained if attention is limited to the full-time labor force and to persons whose major activity is not attending school. Among male teenagers in the full-time labor force, the 1971 unemployment rate was 16.9 per cent; for 20-24 year olds, it was 10.0 per cent. Among males aged 16 through 21 whose major activity was not going to school, the unemployment rate was 13.5 per cent.

An examination of the British experience indicates that such relatively high rates among young persons can be avoided. The 1961 British census[3] showed that the unemployment rate among

[3] It is necessary to use census data for Britain because continuous unemployment statistics are based only on registered unemployment; there is no continuous survey data.

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male non-students aged 16-17 was only 2.1 per cent. The same rate also prevailed for 18-19 year olds and 20-24 year olds. For 25-34 year olds, the rate then fell to approximately 1.6 per cent. British young people have extremely low unemployment rates, both absolutely and (by comparison with the United States) in relation to older workers. I shall return later to what I believe are some of the reasons for the very favorable British experience.

Youth unemployment is not primarily due to inadequate demand. The statistical analysis described above indicates that the unemployment rate of young persons would remain high even in a very tight labor market. There are two main sources of the chronic high unemployment in this age range: (1) unnecessarily slow absorption of new entrants and (2) low job attachment among those at work. Because of the slow absorption, a very significant part of the unemployment of young workers is among new entrants to the labor force and others who are seeking their first full-time job. New entrants to the labor force spent an average of 9.1 weeks until their first employment. Among teenagers, new entrants contributed 6.7 per cent to the unemployment rate; new entrants therefore accounted for 40 per cent of total teenage unemployment.

The single most effective way of reducing unemployment among new entrants as well as improving the quality of first jobs would probably be the establishment of a special Youth Employment Service. The British experience with such a program suggests its potential impact in America. In a recent year in which approximately 280,000 boys between 15 and 17 entered the labor force,[4] the Youth Employment Service arranged 200,000 employment placements for boys in that age group. While some of these placements are not for new entrants, the magnitude of the British achievement is enormous. Part of their success is due to their direct contact with students: Nearly 80 per cent of school leavers who are not going to universities are interviewed in school by the Youth Employment Service.

I would favor a federal program that reimbursed states for the cost of operating a Youth Employment Service that met certain federal standards. The Service should be separate from the regular Employment Service and should deal only with persons below 21 years of age. Although available to those who have already left school, it should focus mainly on an active program of advising and placing those who are about to leave. A participant

[4] Compulsory education in Britain did not extend beyond 15; approximately one fourth of those new entrants between 15 and 17 were 15-year-olds.

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state should require each student to be interviewed by the Youth Employment Service before he graduates from high school or is allowed to leave school legally. Making a Youth Employment Service an integral part of the educational system should facilitate the transition from school to job. The knowledge that everyone entering the labor force is seen by the Youth Employment Service would encourage employers to list jobs that are not now given to the regular Employment Service. If those leaving school are more aware of the options open to them, they are more likely to find a job with which they will be satisfied. They will not only find a better job in this way, but will also be less likely to leave that job in an illusory hope of improving their position.

The instability of teenage employment

The second source of unemployment—the high rate at which young men and women lose jobs, quit jobs, and drop out of the labor force—is both a more serious problem and a more difficult one to solve. Much of the unemployment among experienced young workers occurs not because jobs are unavailable but because they are unattractive. For many young workers, the available entry-level jobs are also dead-end jobs. They offer neither valuable training nor opportunities for significant advancement within the firm. Since employers have made no investment in these workers, they do not hesitate to lay them off whenever demand falls. Since comparable jobs are easy to find, these young workers do not hesitate to quit. The growth of our economy during the past few decades now permits relatively high wages even for those with entry-level jobs. Among the young and single, these high wages encourage an increased demand for leisure. If the content of the job and the structure of the firm's employment policy do not outweigh this, job attachment will be weak and quit rates high.

All of the evidence points to this highly unstable character of employment, rather than to any long-term difficulty in finding jobs, as the primary source of unemployment among experienced young workers. First, the mean duration of unemployment is much lower for this group than for the rest of the labor force. Even in 1971, when the mean duration for all unemployed was 11.4 weeks, among 16-21 year olds the mean was only 8.5 weeks; while 24 per cent of all workers were unemployed for more than 15 weeks, only 15 per cent of 16 to 21 year olds were. Second, unemployment among job leavers and those reentering the labor force is much more

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important for younger workers than unemployment among job losers. In 1971, job leavers and reentrants contributed 7.1 per cent, or more than two thirds, of the unemployment among teenage experienced workers. Third, these high reentrant rates appear to be associated with relatively high rates of being outside the labor force. In 1971, among 16-21 year old males whose major activity was not attending school, more than 13 per cent were not in the labor force. The "non-employment rate" (i.e., the ratio of the unemployed plus those outside the labor force) is therefore an extremely high 27 per cent. Of those 16-19 year olds outside the labor force and not in school, only about one tenth stated the inability to find a job as the reason for not seeking work. Another one tenth indicated ill health and home responsibilities. The rest are reported in the general "all other reasons" category. For 20-24 year olds, the results are very similar; for only one tenth of those outside the labor force was an expected inability to find work the reason for not seeking employment. Finally, a survey[5] that followed the same group of young men from October 1966 through October 1968 found that approximately one fourth of black 16-20 year olds had three or more spells of unemployment and about half had two or more inter-firm shifts during the 24 months. Among whites the proportion experiencing at least one spell of unemployment was similar (after educational differences are taken into account), but multiple spells of unemployment were less common. Still, one fifth of whites and two fifths of blacks between 16 and 24 who were completely out of school experienced some unemployment during those two years despite the very low overall national unemployment rate.

Students and non-students

Why is employment so unstable and labor force attachment so weak in this age range? Why do young American workers experience unemployment rates so much higher than those of their British counterparts? I believe that a fundamental reason is the types of jobs that are available and the lack of adequate reward for stable employment. I will return below to discuss this in more detail and to suggest possible remedies. First, however, I want to emphasize two ways in which the figures overstate the magnitude

[5] The National Longitudinal Survey, sponsored by the U.S. Department of Labor. See Parnes, *et al., Career Thresholds,* Vol. 1, Manpower Research Monograph No. 1, U.S. Department of Labor (Washington, Government Printing Office, 1970).

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of the social and economic problem of unemployment among young people.

Part of the high quit rates and rates of leaving the labor force merely reflects the impact of our educational system and the seasonal character of the labor force activity of students. Those who have not stopped their formal education seek full-time employment when schools are closed and may also seek different part-time jobs during the school year. Since attending school is the major activity of more than 23 per cent of the labor force between 16 and 21 years of age, the peculiar labor market behavior of that group has a substantial impact on the statistical picture of youth unemployment. If those who are looking only for part-time work are not counted in the unemployed, the unemployment rate for 16-21 year olds in 1971 drops from 15.0 per cent to 10.2 per cent. Moreover, many of those who leave school and take jobs later return to being full-time students. High unemployment among young Americans is therefore in part a reflection of our commitment to providing many more years of schooling than is common in other countries, and is a price we pay for a very fluid educational system which encourages people to move back and forth between full-time work and full-time education.

In considering the gap between the unemployment rates of young persons and of more mature workers, it is important not to lose sight of their differences in motivation and attitudes. Most young workers have no family responsibilities and many continue to live with their parents. It is significant that the 1971 unemployment rate for 16-24 year old males who were classified as "household heads" was only 6.4 per cent while all others in this age-sex group had an unemployment rate over 16 per cent. Although today's high wage rates provide a substantial reward for working, they also permit a comfortable standard of living with significantly less work or less responsible work than was required 20 years ago. Many young persons want more leisure than is consistent with full-time employment and a permanent attachment to a particular firm. They prefer to alternate between working and other activities rather than to seek and hold permanent employment. These remarks are not intended as criticism. The behavior of these young persons is seen in better perspective by comparison with our student population. The major activity of over 40 per cent of 16-21 year olds is attending school. The academic schedule provides frequent long vacations. For those in higher education, the daily routine is varied and the individual is generally free to choose his own

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activities and pace of work. Perhaps much of the high turnover and voluntary labor force withdrawal among young non-students reflects an attempt to enjoy the same freedom and occupational irresponsibility that we take for granted in our student population of the same age.

The extremely high unemployment rates are therefore not quite what they seem. They reflect the peculiar labor force behavior of students and the temporary and voluntary unemployment that young people can afford in an affluent society. Despite this, I believe that there does exist a real and serious problem. The high turnover rates and voluntary unemployment are also a response to the unsatisfactory type of job that is available to many young workers. These are often dead-end jobs with neither opportunity for advancement within the firm nor training and experience that would be useful elsewhere. The young worker's incentive to stay at work is often further reduced by a seniority system that implies that the newest employees are most likely to be laid off during the next small business downturn. Moreover, the lack of sufficient opportunities to begin careers leading to high-paying jobs or to obtain valuable on-the-job training in industry and business is no doubt responsible for an excessive reliance on formal education. I shall not venture to guess how many of our college students might be served better by working than by going to school if more adequate jobs were available.

The minimum wage and opportunities for training

At the root of this problem is the hard economic reality that firms cannot afford to offer useful on-the-job training to a broad class of young employees. A firm can generally provide the opportunity to acquire new marketable skills—by on-the-job training, detailed supervision, or even just learning by experience—only to a worker whose net product *during the period of training* is at least equal to his wage. Unfortunately, the current minimum wage law prevents many young people from accepting jobs with low pay but valuable experience. Those who come to the labor market with substantial skills and education need not be affected by the minimum wage. They are productive enough to permit employers to pay at least the minimum wage while also providing further training and opportunities for advancement. But for the disadvantaged young worker, with few skills and below-average education, producing enough to earn the minimum wage is incompatible

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with the opportunity for adequate on-the-job learning. For this group, the minimum wage implies high short-run unemployment and the chronic poverty of a life of low-wage jobs.

In this way the minimum wage law has an unambiguously harmful effect on some young workers. Even if an individual were willing to "buy" on-the-job training by taking a very low wage for six months or a year, the minimum wage law would not permit him to do so. It is unfortunate and ironic that we encourage and subsidize expenditure on formal education while blocking the opportunity for individuals to "buy" on-the-job training.[6] The British experience contrasts sharply with our own. More than 40 per cent of male employees under 20 are classified as apprentices, articled clerks, and formal trainees; less than 18 per cent of males between 16 and 19 are students.[7]

The burden of this effect of the minimum wage law falls most heavily on the disadvantaged. Because they bring little to the labor market, they are able to obtain little in exchange. It is clear from the few successful programs in training the disadvantaged that for some time these workers produce little if any net revenue over the costs of training. A job at the minimum wage will not permit any significant amount of training. The disadvantaged youth for whom more formal education is unsuitable is therefore forced into dead-end jobs without training or opportunities for advancement. In the short run, this means high absenteeism, high quit rates, and high turnover. The long-run effects are even more serious. The lack of additional training for those who start with low skills makes them part of the permanent poor. For the disadvantaged, the minimum wage law may have the ironic effect of lowering lifetime incomes by a very large amount.

Note that this view of the harmful effects of applying the minimum wage law to young workers is quite different from the usual proposition that the minimum wage law creates unemployment because at the established level the supply of workers exceeds the demand. The evidence on that is ambiguous. It is clear that there is no lack of jobs in the sense that nearly any young person can get a job, but it is not certain that they *all* could. The important point is that, because of the minimum wage law, many of the jobs

[6] There are some strange exceptions to this, such as hospital schools of nursing that charge very low fees and obtain substantial services from the student nurses. Presumably, a *negative* wage is consistent with the minimum wage law but not a low positive wage!

[7] Britain has no minimum wage law. Other countries with a minimum wage often treat young workers differently from older workers.

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that are available do not provide young workers and their employers with an incentive for stable employment.

The problem then is to remove the barrier to better on-the-job experience and training that is currently posed for some young workers by the minimum wage law. There are a variety of ways to do this. The method that one prefers depends in part on whom one wants to bear the cost of these better job opportunities. One obvious solution would be to modify the minimum wage law so that its full force does not apply to young workers. This would put the full cost of the better training on the young workers themselves. Although there is strong opposition to changing our current minimum wage system, the case for a minimum wage is clearly the weakest when applied to young workers. At best, the minimum wage is an administratively simple way of providing a minimum annual income for every family with a full-time working member. It suffers even in this context from its failure to relate that income to family size. This is particularly relevant to young workers who are single and who often live with their parents.

Youth employment scholarships

There are, however, two practical objections to relying solely on a reduction in the minimum wage for young workers as the means of facilitating better job experience. First, some young workers could simply not afford to take a job that would provide adequate training and experience. The low incomes associated with such jobs would effectively exclude those with family responsibilities. Single individuals who had to support themselves would also be eliminated from the best programs; the cost of some successful training programs has been so high that without a direct subsidy employers could offer little more than a "tuition-free education." Second, many of those who could both afford and benefit from a low-wage job with training would not take the opportunity. Uncertainty about the future value of the training and impatience for immediate income would lead many to jobs with higher pay but less useful experience. Some form of subsidy is therefore necessary if sufficient on-the-job training is to be achieved. Given the substantial direct and indirect subsidies that are now given to students, a program of subsidies for young workers is only equitable. Such subsidies would also help to reduce the current distorting incentives to choose formal education rather than learning on the job.

The advantage of removing the minimum wage barrier to train-

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ing could be achieved without any change in the minimum wage if a subsidy were paid to employers for all young workers. This would, however, be a very inefficient way to deal with the problem because it would provide the same subsidy regardless of the young person's family income. Such a program would either yield relatively little useful training or be very expensive. A more reasonable solution would be to combine a decrease in the minimum wage with a stipend that is related to the financial situation of the young worker and his family.

A wide variety of alternative programs, differing in the degree of control that the government exercises over the individual's training, could be designed. *Central to all such programs would be a Youth Employment Scholarship paid to young workers as a supplement to their wage income.*[8] At one extreme, each individual would receive his scholarship and make whatever job arrangements he wished. The program would rely on the individual worker to select the job that offered him the most valuable combination of training and current wage. The danger, however, is that because of uncertainty, ignorance, or impatience, many would fail to take advantage of the opportunity to acquire training and would seek the highest current wage.[9] At the other extreme are arrangements like the current JOBS program in which the government contracts directly with firms to provide specific training to individuals selected in a particular way. Neither the rate of acceptance of this program in the business community nor the end results for the trainees have been encouraging. The contract route places undue emphasis on the formal characteristics of the program and puts the government in the inappropriate role of buying specific educational services rather than of subsidizing suitable job settings for young workers. Along the spectrum of possibilities between these two extremes are different combinations of prior approval, supervision, and incentive payments.

III. Four sources of adult unemployment

Unemployment among mature workers reflects several distinct

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[8] Although the size of each scholarship should be related to each individual's circumstances, a minimum stipend independent of family income would be desirable. This would both influence the character of the program and partially offset the current indirect subsidies of formal education that benefit all students.

[9] This tendency could be partly controlled by making the size of the scholarship larger if the wage rate is lower.

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problems. Identifying these separate aspects suggests a mix of possible policies for lowering the unemployment rate. This section will discuss four reasons why the adult unemployment rate is higher than it should be. Several possible policies will be discussed briefly. The next section will consider in more detail the potential effects of changing our unemployment compensation system.

Some unemployment is, of course, the inevitable consequence of a healthy and dynamic economy. The changing mix of output and the process of technological advance displace workers who generally become temporarily unemployed. Women often return to the labor force as their children grow older; in 1971, reentrants accounted for 40 per cent of the unemployment among women 20 years old and over. Families occasionally migrate to new areas in order to find better employment opportunities and then spend time searching for work. All of these sources of unemployment produce important gains for the economy and often for the unemployed themselves. It is clear that they should not be discouraged. In particular, it is important to avoid the temptation—to which other countries have sometimes succumbed—to prevent temporary unemployment by permanent subsidies for unwanted output and inefficient technology.

Although some unemployment among adults is appropriate, the actual unemployment rates among experienced men clearly represent an undesirable and unnecessary waste of resources. In the post-War period, the unemployment rate among males aged 20 and over averaged 3.5 per cent. In 1971, it was an unfortunate 4.4 per cent. As already noted, the rate has generally been higher among women than men. In 1971, it was 5.7 per cent. The combined unemployment rate for adults (persons aged 20 and over) was 4.9 per cent. These rates, and the U.S. post-War experience in general, are much higher than the unemployment rates experienced in most other industrial nations. Even Britain, which unlike some other European countries does not maintain full employment by temporary imports and exports of foreign laborers, achieved an average adult unemployment rate below 2.5 per cent in the 1960's. What could be done in the United States to achieve a comparable performance?

Although better management of aggregate demand has a more important role to play in lowering the adult unemployment rate than in improving the teenage employment situation, macroeconomic policies cannot do the job alone. This point has already been stressed and examined statistically. It is now time to consider the more specific reasons why a variety of policies are needed to achieve

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a more desirable level of unemployment among adult workers. To do so, it is useful to distinguish and analyze the implications of four different sources of adult unemployment: (1) the cyclical and seasonal volatility of the demand for labor; (2) the weak labor force attachment of some groups of workers; (3) the particular difficulty in finding permanent employment for persons with very low skills or other employment disabilities; and (4) the average of several months of unemployment among job losers.

Cyclical and seasonal variation in demand

The American unemployment rate is not only higher than the rates observed in foreign countries but also much more cyclically volatile. During the 1960's, the total U.S. unemployment rate varied from 3.5 per cent to 6.7 per cent. The cyclical variation in unemployment—the gap between peak and trough—was 3.2 per cent. The unemployment rate was nearly twice as high in the worst year as in the best. During the same decade, the corresponding British unemployment rate (adjusted to U.S. definitions) varied from 2.1 to 3.4 per cent. The cyclical variation was only 1.3 per cent, substantially less than half of the U.S. gap. Despite the much lower rate in the best year, the cyclical swing only increased the British rate by some 60 per cent.

It would be wrong to infer from these data that Britain's less volatile unemployment rate is due to a more stable growth of demand and production. A comparison of American and British experience shows instead that changes in aggregate demand have a substantially smaller impact on employment in Britain than they do in the United States. More specifically, I have examined statistically the relation between annual changes in the unemployment rate and the corresponding changes in industrial production in the two countries. The results show that a one per cent change in industrial production has about twice as big an effect on the unemployment rate in the United States as it does in Britain. Moreover, while nearly all of the year-to-year variation in the U.S. unemployment rate can be explained by fluctuations in industrial production, the association between unemployment and industrial production is much weaker in Britain.

British unemployment is less volatile because there is more cyclical labor hoarding and more disguised unemployment in British firms. The reasons for this difference in behavior are unclear. It may reflect specific differences in seniority arrangements and unemploy-

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ment insurance provisions or more general differences in industrial structure, in the competitiveness of product markets, and in long-established national attitudes about the proper relation between employers and employees. Although British employment practices bring advantages in the form of income maintenance and job security, these benefits are paid for by a lower aggregate productivity of labor. It would clearly be valuable to study why British firms and workers have chosen to respond differently from their American counterparts.

A variety of special schemes might be developed in the United States to encourage firms to reduce the sensitivity of employment to changes in aggregate demand: required minimum notice before employees are laid off, large compulsory severance payments, a guaranteed annual wage, substantial tax penalties (or rewards) for volatile (or stable) employment, and the like. Similar policies have already been adopted by some European countries; however, such actions can only lower the volatility of unemployment by reducing the efficiency of the labor market and therefore lowering real wages. There is no reason for the government to impose a lower wage and correspondingly greater employment security than the employees themselves actually want. Collective bargaining agreements can achieve any desired degree of employment security through the same techniques of minimum notice, supplementary unemployment benefits, and so on. The outcome of collective bargaining, moreover, can reflect the employees preferences and the real opportunity costs of lost earnings. The government should only provide inducements to disguised unemployment to the extent that these are considered a more efficient form of deficit spending or that they provide tangible benefits to persons other than the individual employees and employers. It should go without saying that the government should also avoid policies that artificially stimulate the responsiveness of unemployment to changes in aggregate demand. Nevertheless, as I will discuss below, our current system of unemployment compensation has the undesirable effect of stimulating the volatility of unemployment in this way.

Seasonal variation in employment demand raises quite different issues from the cyclical variation that has been discussed until now. Seasonal unemployment is clearly not involuntary. An individual who accepts a job with seasonal fluctuations knows that he will be laid off or at least that there will be a significantly higher probability of being laid off. The total effect of seasonal variations in unemployment is substantial. During the twelve months from June 1971

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through May 1972, the seasonally adjusted unemployment rate remained nearly constant, varying only between 5.2 and 5.5 per cent. In the same period, the seasonally unadjusted rate varied from a low of 4.5 per cent to a high of 6.3 per cent. If seasonal unemployment could be avoided completely, the average unemployment rate would fall by more than 0.75 per cent. While some seasonal unemployment may be technically necessary, other seasonal unemployment could no doubt be eliminated by changes in production methods, increased holdings of inventories, the integration of firms with complementary seasonal demands, and other means. Additional reductions in seasonal unemployment could be achieved if workers who are seasonally laid off would make the transition to new jobs with less time out of work. If these improvements could eliminate half the current seasonal unemployment, more than 300,000 man-years of unemployment could be avoided every year. It should be emphasized, however, that some amount of seasonal unemployment is desirable. Even if public policies could be designed to eliminate seasonal unemployment completely, this would only be achieved at substantial real economic costs. The proper aim of public policy should be to avoid distorting the natural pattern of seasonal unemployment that would reflect both the preferences of employees and the attempts of employers to produce at minimum cost. I will discuss below the ways in which our current system of unemployment insurance encourages excessive seasonal layoffs and unnecessarily long unemployment among those who have been laid off.

Weak labor force attachment

Unemployment caused by weak labor force attachment is generally a smaller but more serious problem among adults than among young workers. While some of the unemployed adults who are not seeking permanent employment are still students or are mothers with young children, the social problems are associated with the group with low skills and little education. These adults suffer from the same limited opportunities as some of the young workers described in the last section. Because they have low skills, little education, and generally bad work habits, they never enter the mainstream of employment opportunities. The only jobs open to them are the dead-end jobs with low pay and no future.

High unemployment among the men and women in this "secondary labor market" reflects their rejection of the jobs that are

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available.[10] Many of those with very limited job opportunities prefer to remain unemployed rather than accept what they consider undesirable jobs. Many others who take these jobs soon quit.

Boston's experience with trying to secure employment for a large group of such low-skill workers dramatically illustrates that the problem is not providing jobs but making these jobs acceptable to the unemployed. During the eight months beginning in September 1966, Boston's ABCD program referred some 15,000 disadvantaged workers to jobs. Seventy per cent were actually offered jobs. Nearly half of the job offers—45 per cent—were rejected. Of those who did accept work, less than half remained on the job for one month. A very high proportion of these separations were voluntary. Even among those over age 25 who were being paid more than $1.75 per hour in 1967, the separation rate in the first month was 33 per cent.

What can be done to reduce unemployment among low-skilled adult workers? It is clear that the problem cannot be solved by increasing aggregate demand in order to create more jobs. There is no evidence of a shortage of jobs for this group. The Boston experience shows that jobs can be found but that they will not be accepted.[11] *Lowering the rate of unemployment requires steps to bring the characteristics of the actual jobs and the standards of the acceptable jobs closer together.*

It is sometimes suggested that expansionary macroeconomic policy can play an important role by improving the quality of the jobs available to the least able workers. Those who support this view argue that the better jobs and higher pay that become available in a tighter labor market will reduce the voluntary unemployment and non-participation among this group. There is, unfortunately, insufficient data with which to evaluate this proposition. The aggregate unemployment statistics by age, sex, and race do not provide enough detail to identify the low-skilled workers. Although such workers are a disproportionately large fraction of non-white males, it is impossible to say how much of the fall in unemployment for this group during any cyclical tightening is actually due to a reduction in voluntary unemployment among those who are able to find better jobs.

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[10] See P. Doeringer and M. Piore, *Internal Labor Markets and Manpower Analysis* (Lexington, Mass., 1971), Chapter 9, for an extensive discussion of the characteristics of the secondary labor market.

[11] The special problem of those with such severe employment handicaps that they cannot earn the minimum wage will be discussed below. See P. Doeringer, *Programs to Employ the Disadvantaged* (Englewood Cliffs, New Jersey, 1969), for a more detailed description of this experience.

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The best available evidence—the statistics on labor force participation rates—indicate a pessimistic conclusion. Since 1948, the labor force participation rates of non-white adult males have dropped dramatically: from 97.2 per cent to 92.0 per cent among 35 to 44 year olds, and from 94.7 per cent to 86.9 per cent among 45 to 54 year olds. (Among white males in those age groups the changes were extremely small: from 98.0 per cent to 97.0 per cent and from 95.9 per cent to 94.7 per cent.) This nearly threefold increase in voluntary withdrawal from the labor force occurred during a 25-year period in which wage rates rose nearly 50 per cent. This is clearly contrary to the notion that higher wage rates would reduce voluntary non-employment. Much of the decrease in labor force participation occurred at the same time as labor markets were tightening. From 1961 through 1969, while the overall unemployment rate was falling from 6.7 per cent to 3.5 per cent, non-white adult male labor force participation rates also continued to fall: from 94.8 per cent to 92.7 per cent among 35 to 44 year olds and from 92.3 to 89.5 per cent among 45 to 54 year olds.

Similar conclusions are implied by the fall in the labor force participation rates of non-white adult males living in urban poverty neighborhoods during the period from 1967 through 1969, when the unemployment rate for that group was falling sharply. In 1967, with an unemployment rate of 5.7 per cent among non-white adult males in urban poverty areas, 19.6 per cent of that group were neither employed nor seeking work. By 1969, their unemployment rate had fallen to 4.3 per cent, but despite the tightening of the labor market, non-participants rose to 21.4 per cent of that population group.

The evidence on non-participation rates contains two lessons. It is a warning that macroeconomic expansion and tighter labor markets are unlikely to bring a significant reduction in the voluntary unemployment that characterizes low-skill groups. It is also a reminder that the officially defined unemployment rate is the tip of the iceberg. For these low-skill groups, withdrawal from the labor force is much more common than official unemployment.

Manpower programs and voluntary non-employment

Recognition of these limits of expansionary macroeconomic policies has encouraged the creation of several major manpower programs during the past decade. All these programs share the common philosophy that the best way to reduce non-employment in

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the groups designated as disadvantaged is to provide training that can improve the quality of jobs open to them. During the nine years from 1963 through 1971, there were more than six million new enrollments in federal manpower programs. The total federal cost of these programs from 1963 through 1971 was nearly $7 billion; in 1971, the federal obligation was $1.5 billion.

Despite 10 years of experience with these large programs, there has been no clear and definitive evaluation of their impact. We do not know whether unemployment rates are lower and participation rates higher for those who have enrolled in a manpower program than for those with the same characteristics of age, sex, education, etc., who have not. There have apparently been no controlled experiments to compare the effects of institutional training under the MDTA program with on-the-job training in the JOBS program. The isolated evaluations of particular local experiences or the results within individual firms have generally suggested that manpower programs have positive but small effects. The interpretation of these evaluations is clouded, however, by a lack of adequate controls and by the problem of self-selecting trainees. The clearest successes have been obtained by large firms that have combined expensive periods of on-the-job training with opportunities for further employment and advancement.[12]

Among adults who have been out of school for several years or more, the handicap of low skills is exacerbated by the problem of bad employment habits. Absenteeism, frequent lateness, petty thefts, and high quit rates are characteristic of workers in the secondary labor markets. It is difficult for them to break these habits and conform to the discipline of mainstream employment. The possibility of preventing these problems by means of better experience and training for young workers makes the policies discussed earlier all the more important.

Both macroeconomic policies and manpower programs seek to reduce non-employment by making the available work more attractive. It is important not to lose sight of the fact that the extent of voluntary non-employment also depends on the attractiveness of not working. Today's welfare rules are a notorious deterrent to work for those who are receiving welfare. Moreover, the rapid rise during the last decade in the value of public assistance available to a

[12] See Robert Hall, "Prospects for Shifting the Phillips Curve Through Manpower Policy," *Brookings Papers on Economic Activity* (1971), for a discussion of this evidence and a generally pessimistic view of the potential of manpower programs. Peter Doering provides several case studies in *Programs to Employ the Disadvantaged* (1969).

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family with little or no earnings—including cash payments, Medicaid, food stamps, and housing subsidies—has substantially increased the attractiveness of non-employment or intermittent employment for those with low skills. The increased levels of unemployment compensation also encourage intermittent work, especially among two-earner families.

There is also the complex problem of unreported earnings among low-income families. Some of this derives from criminal activities or from lawful services performed for illegal employers. But cash payments designed to avoid taxes and to prevent reductions in unemployment compensation or welfare benefits are also important. For casual workers in the secondary labor market, cash payments can avoid federal income taxes at a minimum marginal rate of 14 per cent, plus combined employer and employee social security taxes in excess of 10 per cent, plus state income, unemployment compensation, and workmen's compensation taxes. These taxes may easily total more than 30 per cent of the worker's gross pay. By evading taxes and receiving payment in cash, the effective net wage can be increased by nearly 50 per cent. This provides a substantial incentive to both employers and employees in situations where record-keeping practices can be lax to share the potential gains of non-reporting. The higher wages in such casual labor markets are a further inducement to intermittent employment.

The most effective way to achieve a substantial reduction in non-employment among low-skilled groups is to combine improved manpower programs with a reexamination and redesign of the current adverse incentives.

The current unemployables

In addition to those who are cyclically unemployed or voluntarily out of work, there is a substantial residue of unemployables who would be unable to find steady employment even in a very tight labor market. Permanent physical disability, subnormal intelligence, or psychological problems severely limit the productivity of these men and women. The problem is most serious among those with both a physical impairment and limited education. Law and custom prevent firms from lowering wages to the levels at which it would pay to hire handicapped individuals.

Although vocational rehabilitation could improve the prospects for some of them, in many cases—especially among those who are older and less educated—the costs of additional training would ex-

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ceed the benefits. *Two forms of job creation for these permanently disadvantaged workers have been suggested: subsidies to firms and direct permanent public employment. A third option, integrating the minimum wage law with general income maintenance, is also possible.*

Wage subsidies to private firms are designed to fill the gap between the productivity of these very low-skilled workers and the minimum wage. The primary objection to such a policy is that much of the subsidy would be paid for hiring workers who would have been hired anyway. Although this problem might be reduced by a careful procedure of certifying eligible handicapped workers, such a process would inevitably involve a large number of arbitrary individual decisions. The task would be made more difficult by the need to specify different subsidies for different degrees of occupational handicap. The scope for abuse, however, would be very much limited if the total wage (including the subsidy) were limited to the legal minimum wage in that type of employment and if the handicapped individual could take his wage subsidy to any employer. Since most workers can earn more than the minimum wage, there would be no incentive to seek an inappropriate wage subsidy. Even if low-skill workers in general were subsidized excessively, there would be no undue subsidy to employers if workers could take these subsidies to any firm. Competition among firms for these subsidies would pass the advantage of the subsidy back to the low-income workers themselves. The most serious problem with the subsidy plan would then be that substantial government funds would go to raising the wages of very-low-paid employees rather than to reducing unemployment.[13] A system of wage subsidies to close the gap between the productivity of handicapped workers and the minimum wage is therefore quite appealing. It would of course be appropriate to permit state and local governments to compete with private firms in hiring workers with wage subsidies.

Permanent public employment for those who are currently unemployable in the private sector is advocated by those who doubt the potential efficacy or cost-effectiveness of private wage subsidies. A further advantage claimed for public employment is that the gov-

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[13] A second objection to the use of wage subsidies is that for some workers no feasible subsidy would be large enough to induce an employer to hire them if managers fear that, because of their unreliability, production lines would be interrupted, machinery destroyed, and so on. This is unlikely to be a very serious problem. Although such unreliability may make some people unemployable at any wage in some firms and occupations, there are clearly other jobs in which they could be profitably employed at a sufficiently low net wage.

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ernment, unlike private employers, could give primacy to job creation and make the production of a useful product a secondary consideration. Such a philosophy currently guides the program of sheltered workshops for the blind and for others with severe physical or mental impairments. Should it, however, be extended to those with less obvious occupational handicaps? The difficulty with a program of public employment is indicated by the question posed by Charles Schultze and his colleagues:

> What would be the appropriate size of a public employment program? The answer depends on the answers to two other questions: How many potential enrollees are there, and what proportion of them would actually enroll? . . . Two alternative actions might be taken to determine the "proper" size of a public employment program. One would be to guarantee a job to everyone applying, and find out how many do apply. A more practical procedure would be to start at a relatively low level and, if the jobs offered at that level were quickly snapped up, to offer more until some acceptable degree of saturation is reached.[14]

The number of enrollees would, of course, depend on the rate of pay and the conditions of work. If the pay were not limited to the minimum wage, workers would be drawn away from productive private employment into these unproductive public positions. Even if these special public employees were only paid the minimum wage for manufacturing employees, workers who are currently employed in private jobs in agriculture and services would find public employment more advantageous. If the managers of the public employment program consider any useful output to be of secondary importance, public employment is likely to be less productive and therefore more costly to the nation than private wage subsidies. Moreover, if the case for subsidized job creation rather than direct income support is based on the value to the individual of a sense of accomplishment, it is important that the employee be involved in useful production. There seems little reason to support a program of public employment with little concern for production unless a program of private wage subsidies has been tried and rejected.

An alternative to the development of a formal wage subsidy program is to integrate the minimum wage law and the system of income maintenance. With a negative income tax, such an integration could be accomplished simply if the minimum wage were interpreted as applying to the sum of the employee's market wage and

[14] C. Schultze, E. Fried, A. Rivlin, and N. Teeters, *Setting National Priorities; The 1973 Budget* (Washington, Brookings Institution, 1972), pp. 200-201.

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the income maintenance payment converted to an hourly basis.[15] The rules would have to take into account the problems of families with more than one earner, of varying wage rates, and of temporary unemployment, but this could be done without altering the basic notion of integrating income maintenance and the minimum wage. Such an integration would strengthen the income maintenance provisions for those who would otherwise be involuntarily unemployed while avoiding the cumbersome administrative problems of direct wage subsidies.

Duration of unemployment

A worker who is laid off often does not accept the first job offer in his own line of work but investigates several job possibilities over a period of weeks before accepting new employment. Part of this process of searching is information gathering. The worker who has not recently been unemployed generally does not know what wage and working conditions his own skills and experience will command in the market. He spends time locating relevant jobs and learning about them. Part of the search also consists of delaying in the expectation that the next job offer may be better. The greater the individual's uncertainty and the greater the variance of wage rates and working conditions in his relevant market, the longer he will tend to search.

Not all unemployment can be interpreted as conscious or unconscious search. Some skilled workers and union members know just what the local market wage is in their occupation and prefer to

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[15] For example, if the minimum wage is $2 per hour, an individual who receives $1500 per year in income maintenance would be treated as receiving support of 75 cents per hour for 2000 hours and could therefore accept a job that paid anything over $1.25 per hour. The actual application of such a principle would take into account the fact that the annual income maintenance payment depends on the amount that the individual earns. As a simplified example, consider an income maintenance scheme that pays an annual amount A equal to a basic payment B (that depends on family size) less one half of the annual earned income INC: $A = B - \frac{1}{2}(INC)$. The income maintenance and minimum wage rules might be integrated by defining income, for the purpose of the minimum wage control, as 2000 times the individual's market wage ($WAGE$). This implies that the hourly income maintenance payment ($a = A/2000$) is: $a = B/2000 - \frac{1}{2} \times INC/2000 = B/2000 - \frac{1}{2} WAGE$. The gross wage to which the minimum wage law applies is then the sum of the market wage and the hourly income maintenance payment: Gross Wage $= WAGE + a = WAGE + B/2000 - \frac{1}{2} WAGE = B/2000 + \frac{1}{2} WAGE$. An individual with a basic payment of $3000 therefore earns a gross wage of $1.50 per hour plus one half the market wage. If the minimum wage is $2.00 an hour, the individual can accept a job with a market wage above $1.00 an hour. If the basic payment is smaller, the minimum market wage is higher. If the basic payment exceeds $4000, the individual can accept any form of employment.

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wait until such work becomes available rather than accept alternative work at lower pay. Some workers are waiting to be rehired into the same job from which they were temporarily laid off because of a seasonal or cyclical fall in demand or because of scheduling problems. Some workers, especially those with severe handicaps, are not able to find any employment. At the other extreme, some of those who report themselves as unemployed and looking for work are actually temporarily out of the labor force and not interested in finding employment.

The average duration of unemployment during the post-War period has been about three months. This varies cyclically: In 1971, it was 11 weeks; in 1969, it briefly dropped below eight weeks, and in 1961, it rose to over 16 weeks. These mean durations reflect a very skewed distribution. Although the mean in 1971 was 11 weeks, more than two thirds of the unemployed had durations of less than 11 weeks and 45 per cent were out of work for less than five weeks.

Any reduction in the mean duration of unemployment would lower the average unemployment rate. *A fall of one month in the average duration of unemployment would lower the unemployment rate from 4.5 per cent to less than 3.0 per cent. Even a two-week reduction would reduce the unemployment rate by 0.75 per cent.* Those who stress the importance of search activity suggest that the duration of unemployment could be reduced by improving the flow of job market information. The computerized "job banks" recently developed by the Department of Labor are a primary example of how this might be done.

The duration of unemployment also depends on the cost to the unemployed of remaining out of work. Our current system of unemployment compensation substantially reduces—indeed often almost completely eliminates—the cost of temporary unemployment. Because unemployment compensation affects not only the duration of job search by the unemployed, but also the cyclical and seasonal variation in labor demand and the job attachment of many low-skill workers, it will be dealt with more generally in the next section.

IV. The effects of unemployment compensation

For more than 30 years, unemployment compensation has provided valuable support for millions of unemployed workers and has been an important source of security to millions more who are employed. It is important to reexamine and strengthen this system by adapting it to the changing nature of unemployment.

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All of the basic features of our current unemployment system were designed and adopted in the depths of the Depression. The modern Keynesian principles of income determination were neither understood nor accepted. Now we are all Keynesians. We have come to accept the government's general responsibility for maintaining a high level of demand through variations in spending, taxation, and monetary policy. The structure of unemployment has changed accordingly. The large pool of long-term unemployed workers has been replaced by a much smaller relative number whose durations of unemployment are also much shorter. Almost every unemployed person can now find a job in a very short time. But despite the changing nature of unemployment, the system of unemployment compensation continues essentially in its original form.

Under the economic conditions that have prevailed in the post-War period, our current system of unemployment compensation is likely to have increased the average rate of unemployment. The usual presumption, that unemployment compensation reduces unemployment because it automatically increases government spending when unemployment rises, is really irrelevant. The same fiscal stimulus would now be provided through other expenditure increases or tax cuts by a government committed to maintaining aggregate demand. The primary effect on aggregate unemployment of our current system of unemployment compensation is not its contribution to aggregate demand but its adverse impact on the incentives of employers and employees. As a result, unemployment compensation is likely to increase nearly all sources of adult unemployment: seasonal and cyclical variations in the demand for labor, weak labor force attachment, and unnecessarily long durations of unemployment.

Our current system of unemployment has two distinct but related bad incentive effects. First, for those who are already unemployed it greatly reduces and often almost eliminates the cost of increasing the period of unemployment. Second, and more generally, for all types of unsteady work—seasonal, cyclical, and casual—it raises the net wage to the employee relative to the cost to the employer. The first of these effects provides an incentive to inappropriately long durations of unemployment. The second provides both employers and employees with the incentive to organize production in a way that increases the level of unemployment by making the seasonal and cyclical variation in unemployment too large and by making casual and temporary jobs too common. Both of these disincentive effects require further explanation.

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A detailed example can be very helpful. Consider a worker in Massachusetts in 1971 with a wife and two children. He earns $500 per month or $6000 per year if he experiences no unemployment. She earns $350 per month or $4200 per year if she experiences no unemployment. If he is unemployed for one month, he loses $500 in gross earnings but less than $100 in net income. How does this occur? A reduction of $500 in annual earnings reduces his federal income tax by $83, his Social Security payroll tax by $26, and his Massachusetts income tax by $25. The total reduction in taxes is $134. Unemployment compensation consists of 50 per cent of his wage plus dependents' allowances of $6 per week for each child. Total unemployment compensation is therefore $302. This payment is not part of taxable income. His net income therefore falls from $366 for the month if he is employed (i.e., his $500 gross earnings less $134 in taxes) to the $302 paid as unemployment compensation. *The combination of taxes and unemployment compensation imposes an effective marginal tax rate of 87 per cent*—i.e., the man's net earnings fall by only 13 per cent of his gross pay ($64) when he is unemployed for a month. The same very high marginal rate continues for several more months. If he returns to work after one month, his annual net income is only $128 higher than if he returns after three months. Moreover, part of this increase in income would be offset by the cost of transportation to work and other expenses associated with employment.

If the man does not become unemployed but his wife loses her job, the implied marginal rate may be even higher. If she is unemployed for three months, her gross earnings fall by $1050 but the family's net income may fall by only $72. The fall in earnings reduces taxes by $297 while the unemployment compensation provides $525 in regular benefits and an additional $156 in dependents' benefits.[16] *The effective marginal tax rate is over 93 per cent. If the family has three children instead of two, the family's net income is actually higher if the woman is unemployed for three months than if she works for that period.*

These astounding figures are not very sensitive to the specific details of the example. Extremely high effective marginal rates would also be implied if the man were not married, or if he were married but his wife did not work, or if his income were 30 per cent higher or lower. For example, a single man with earnings of $500 per month

[16] In Massachusetts the wife may collect dependents' benefits when her husband is still employed if she has previously listed the children as income tax dependents.

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faces a 78 per cent marginal rate. If he is married with two children and his wife does *not* work, his marginal rate is 84 per cent. With monthly earnings of $650, the unemployed married man with two children has an effective marginal rate of 83 per cent; if his monthly income is $350, the marginal rate is 87 per cent. In every case, a middle-income or lower-income individual loses almost no net income if he is unemployed for a short time. Only as incomes rise substantially does the net income loss become significant. For a married man with two children and monthly earnings of $900, the effective marginal rate when he becomes unemployed is 63 per cent; with monthly earnings of $1500 the marginal rate falls to 49 per cent.

In some industries the cost of unemployment is reduced further or even made negative by the supplementary unemployment benefits paid by employers under collective bargaining agreements. The effect of these is particularly important because it continues to apply on an earnings-related basis even above the level at which the state unemployment compensation plans reach their maximum.

Incentives to prolonged unemployment

How do people respond to these very high rates of marginal net unemployment compensation? The response of course varies among individuals and differs according to specific circumstance. But the overall effect is almost certainly to increase the duration of the typical spell of unemployment and to increase the frequency with which individuals lose jobs and become unemployed.

Consider first the duration of unemployment. As we have seen, a man who normally earns $500 per month will lose only about $75 of additional net income if he remains out of work for two months instead of one month. Each additional week of unemployment costs him less than $20, substantially less if there are costs for traveling to work, union dues, and other expenses connected with employment. The unemployed person who does not expect to be recalled by his previous employer can expect to find a better job by searching and waiting for a longer time. Because the cost of additional waiting time and searching time is so very low, the unemployed worker is encouraged to wait until there is almost no chance of a better job. For example, since finding a job that pays as little as five per cent more means an increase in net income of approximately $200 per year, even an additional 10 weeks of unemployment would pay for itself within a year. It is clear that an individual who is actively

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searching for a better job in this way is neither loafing nor cheating. He is engaged in trying to increase his long-run income. *His search is economically rational from his personal point of view but inefficiently long for the economy as a whole.* The unemployed individual loses valuable productive time in order to achieve a slight gain in future income because taxpayers provide a $1000 subsidy during his 10 weeks of increased search.

Not all the increased duration of unemployment is due to the search for a better job. When the return to work adds less than $20 to the week's net income, there is certain to be a strong temptation to use some time for doing repairs and other tasks at home or simply taking a short period of additional vacation. Some who are waiting to be recalled to a previous job may also engage in casual work for unreported income. All of these temptations are likely to be even stronger when there is another person in the family who is employed. Glaring evidence of this type of voluntary unemployment is found in the "inverse seniority" provisions that are now part of the employer-employee agreements in several industries; these provisions give workers with more seniority the privilege of being laid off *earlier* than other workers and rehired *later*.

There are, of course, rules in our unemployment compensation system designed to limit the extent to which individuals voluntarily extend their duration of unemployment. A worker who is deemed unavailable for work or who refuses suitable employment may be disqualified from receiving benefits. Although this may prevent flagrant abuses and deter some from any voluntary unemployment, it is commonly observed that many who could find employment in their own line of work are able to continue receiving unemployment benefits. The state Employment Service is limited in its ability to find suitable jobs for unemployed workers because it is only notified of a fraction of all openings. Moreover, it is not at all difficult for a worker who is interviewed by a prospective employer to avoid being offered a job if he prefers to remain unemployed.

Incentives to more unstable employment

Longer durations of unemployment are only the first of the bad incentive effects identified above. The more general effect of unemployment compensation is to increase the seasonal and cyclical fluctuations in the demand for labor and the relative number of short-lived, casual jobs. It does this by raising the employee's net wage for such unstable jobs relative to the cost to employers. This

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distortion in the cost of unstable employment influences the patterns of production and consumption in the economy. *Because the price of unstable labor has been artificially subsidized, employers organize production in a way that makes too much use of unstable employment.* Similarly, the economy as a whole consumes relatively too much of the goods that are produced in this way.

A worker who accepts a seasonal job knows that he will be laid off (or will have a much greater risk of being laid off) when the season ends. Similarly, a worker in a casual or temporary job or in a highly cyclical industry knows that he is much more likely to be laid off than a worker with a regular job in an industry that is not cyclically sensitive. If there were no unemployment compensation, workers could be induced to accept such unstable jobs only if the wage rate were sufficiently higher in those jobs than in the more stable positions in which they could find alternative work. The pay differentials among jobs would reflect the chances of being laid off and the expected duration of unemployment after being laid off. The higher cost of labor in unstable jobs would induce employers to reduce the instability of employment by greater smoothing of production through increased variation in inventories and delivery lags, by additional development of off-season work, by incurring costs to improve scheduling, by less cyclical sensitivity of employment to changes in production, by the introduction of new techniques of production (e.g., new methods of outdoor work in bad weather to reduce seasonal layoffs), and so on. The higher wages in unstable employment would also increase the prices of the output produced by such firms and industries. The higher prices of these goods and services would reduce the demand for them. This would further reduce the amount of unstable employment in the economy.

In the absence of unemployment compensation, the amount of unstable employment would reflect the employees' balancing of higher wages and employment stability, the employers' attempts to produce at minimum cost, and the consumers' choice among goods and services at prices that reflect their cost of production. The effect of unemployment compensation is to offset the market forces that would otherwise prevent an excessive amount of unstable employment. Because unemployment compensation provides a subsidy to workers in unstable employment, it reduces the wage differential required to attract workers to seasonal, cyclical, and temporary jobs. Because employers pay a relatively small premium for their unstable employment, there is little incentive to reduce this instability. Finally, the prices of these goods and services do not reflect the

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higher social cost of production with unstable employment. The taxpayers subsidize the consumption of those goods whose production creates the most unstable employment.[17]

Imperfections in financing

To what extent are these harmful incentives offset by the current method of financing unemployment compensation through an experience-rated employer tax? Employers contribute to the state unemployment compensation fund on the basis of the unemployment experience of their own previous employees. Within limits, the more benefits that those former employees draw, the higher is the employer's own tax rate. The theory of experience rating is clear. If an employer paid the *full* cost of the unemployment benefits that his former employees received, unemployment compensation would provide no incentive to an excess use of unstable employment. Although money wages would not be substantially higher for such jobs, the total cost to the employer would be.

In practice, however, experience rating is a very imperfect check on the disincentive effects of unemployment compensation. There are three reasons for this. First, the extent of experience rating is limited by a maximum rate of employer contribution. The maximum rate applies when its reserve ratio is below some low level, generally five per cent or less. In the long run, any firm in which average annual benefits generally exceed average annual contributions will pay the maximum rate of the tax. A firm in a seasonal industry that lays off 20 per cent of its average labor force for two months each year will pay the maximum rate if the average wage of those laid off is equal to or greater than $500 per month. More generally, using the three-month mean unemployment duration and assuming that those who become unemployed had earned an average of $500 per month, any firm in which an average of 11 per cent of the average labor force become unemployed each year will pay the maximum. A study of experience in Massachusetts found that in 1959 the maximum tax rate was paid by 31 per cent of construction employers, 40 per cent of apparel manufacturers, and 26 per cent of leather manufacturers. For any firm that already pays the maximum rate,

[17] In describing the harmful effects of unemployment compensation, I do not wish to imply that these outweigh the benefits of the program. Unemployment compensation provides valuable support and security to millions of workers. The problem, however, is to redesign the system to preserve the advantages while reducing the harmful incentives. I will return to this below.

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there is no cost for additional unemployment and no gain from a small reduction in unemployment.

The second reason that the current method of experience rating has only a limited deterrent effect is that the relation between current layoffs and contributions is often quite weak. This is partly because the unemployment tax reflects the firm's entire experience since the beginning of the unemployment compensation system. A firm that has paid contributions in excess of benefits for a long time will have a very high reserve ratio and a contribution rate that will not respond to a change in the layoff rate for a long time. The weak link between layoffs and the contribution rate is also due to the way in which the system pools all workers in the firm. A firm in which most employees are not subject to seasonal or cyclical variations can have high layoff rates for certain jobs and in certain product lines without increasing its contribution rate.

Even if there were neither a maximum rate nor a minimum rate and the contribution rate responded quickly and continuously to changes in the unemployment rate, there would still be a strong incentive to excessive unemployment. This occurs primarily because a worker who is temporarily unemployed avoids income tax and social security payroll tax at his maximum marginal rate on the lost earnings while paying no tax on the unemployment compensation. Since the marginal rate for even relatively low-income families can be over 30 per cent when federal, state, and payroll taxes are combined, the tax effect is quite substantial. In the example discussed above, a married man with a working wife and two children whose wage rate is $500 per month would receive only an extra $64 of net income by reducing his unemployment from two months to one month; if his unemployment benefits were taxed in the same way as other earnings, he would receive more than twice as much, $154. The $90 differential represents a current subsidy out of general tax revenues in addition to the unemployment compensation.

In summary, it is clear that our current unemployment compensation system provides incentives to employers and employees to behave in ways that increase the rate of unemployment in our economy. Although there have been no careful studies to assess the magnitude of these incentive effects, there is a variety of statistical evidence to support the common observation that these effects are economically important. It has been shown that the number of weeks of unemployment per year declines sharply as the wage rate increases. Moreover, mean durations of unemployment appear to be longer in states with more ample unemployment benefits. The very existence

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of the "inverse seniority" provisions shows that some workers value the opportunity to become unemployed.

The lessons of the British experience

The recent British experience is particularly interesting. Until 1966, unemployment insurance in Britain paid a relatively low flat-rate benefit that was not related to the unemployed person's previous earnings. There was also an additional flat-rate dependents' allowance. The "earnings-related supplement," first payable in September 1966, provided for an additional payment equal to one third of the claimant's previous average weekly earnings between £9 and £30. The maximum supplement was therefore £7. The total benefit is subject to a maximum of 85 per cent of the average weekly earnings. The effect of the earnings-related supplement was, in effect, to convert the British system from one with very low relative unemployment benefits for all but the lowest wage group to a benefit structure more similar to that in the United States.

In October 1966, one month after the change in unemployment insurance, British unemployment began rising dramatically. The number of registered unemployed rose from 340,000 in September to 436,000 in October and 543,000 in November. The registered unemployment rate for males rose from 1.6 per cent in August to 3.3 per cent in January. It is, of course, difficult to know how much of this increase should be attributed to the change in unemployment compensation. Other macroeconomic and tax policies occurred at approximately the same time. It is noteworthy, however, that unemployment rates had been above three per cent only once before in the post-War period (during an unusually bad winter) and that such a rapid rise in the rate of unemployment had not been seen before. Moreover, the male unemployment rate has remained over three per cent ever since. The previous relation between the unemployment rate and the vacancy rate ceased to hold after 1966. An examination of the occupational composition of unemployment shows that the proportional rise in unemployment was greatest among skilled married workers and least among the lower-paid unskilled workers (who would benefit less from the earnings-related supplement). The increase among professional, technical, and administrative occupations was also greater than would be expected on the basis of recessions in the recent past. A survey of unemployed workers designed to evaluate the effect of the earnings-related supplement found a significant effect: An increase of £1 per week in

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the level of unemployment benefits tended to increase the length of unemployment by almost half a week. Although there are problems in interpreting each piece of data on the British experience, the evidence as a whole clearly indicates that the new method of earnings-related unemployment compensation has raised the level of unemployment.

There is little room for doubt about the qualitative conclusion that our current system of unemployment compensation increases the rate and duration of unemployment. Although the magnitude of this effect is unknown, it should be emphasized that rather small changes in the duration of unemployment, the cyclical and seasonal fluctuation in labor demand, and the frequency of temporary jobs can have a very important impact on the overall rate of unemployment. A reduction of two weeks in the current average duration of three months would by itself lower the overall rate of unemployment by 0.75 per cent. If one third of the seasonal unemployment were avoided, the overall unemployment rate would fall by an additional 0.25 per cent. If the cyclical variation in labor demand were also reduced by 20 per cent,[18] this would reduce unemployment by another 0.25 per cent. A decrease in the number of casual temporary jobs would have a further impact. Although each of these changes is small, the total effect is a fall in the unemployment rate of more than 1.25 per cent. These numbers should not be interpreted as specific estimates of the extent to which our current system of unemployment compensation raises the unemployment rate. They should be viewed as illustrations of the powerful cumulative effect of small changes in the several sources of adult unemployment. It is quite possible, however, that the disincentive effects of our current system are responsible for at least this much increased unemployment.

Improving the current system

The challenge at this time is to restructure the unemployment compensation system in a way that strengthens its good features while reducing the harmful disincentive effects. The virtue of our system is that it permits the family of a lower-income or middle-income worker who is temporarily unemployed to maintain approximately its previous level of spending. Although the fall in net income is relatively greater among higher-income workers, almost all in-

[18] Recall that the post-War cyclical variation in British unemployment is substantially less than half the American experience.

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sured families are protected against a substantial change in net income. The disadvantage of our current system is that it raises the rate of unemployment and imposes a loss of economic welfare. This welfare loss occurs because the unemployment compensation system encourages each individual employee to act in a way that is in conflict with the interests of all employees as a group. More specifically, although most of the cost of the unemployment benefits and the reduced federal and state tax collections falls ultimately on employees as a whole,[19] each individual employee is induced to behave in ways that increase this cost. It is rational for the unemployed individual to delay returning to work and for the job seeker to give less than the correct weight to the risk of future unemployment. For the group as a whole, however, such behavior incurs costs that far outweigh the benefits. This is the essence of the loss of economic welfare.

What could be done to reduce the harmful disincentives without losing the valuable features of unemployment compensation? Some gains could be achieved by removing the ceiling on the employer's rate of contribution and by lowering the minimum rate to zero. Employers would then pay the full price of the unemployment insurance benefits. The change in the rates of contribution would encourage employers to stabilize production and employment. It would also tend to increase prices for goods produced in firms with unstable employment. This would have the effect of shifting production to firms and industries with more stable employment.

Further improvement could be achieved if unemployment insurance benefits were taxed in the same way as other earnings. This would eliminate the anomalous situations in which a family's net income is actually reduced when an unemployed member returns to work. More generally, it would significantly reduce the very high implicit marginal tax rates that an unemployed person faces when he considers returning to work. It would also end the distorting situation in which, for the same total cost to the employer, a worker with some unemployment during the year receives more net income than a fully employed worker. Since the lowest-income families pay no income tax, the taxation of unemployment benefits would not be a burden to the poor. Even at higher incomes, the total effect on family income of taxing benefits would be small even though the marginal effect is sizable. In any case, the current system is inequita-

[19] The fact that the tax is nominally paid by employers is irrelevant. The variable rate makes the incidence issue more complex, but the statement in the text is essentially correct.

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ble in imposing a higher tax on an employed person than a person *with the same net income* and family circumstances who does not work steadily throughout the entire year.

An individual experience plan

A much more important reform could be achieved by shifting the basis of experience rating from the firm to the individual. This would have the advantage of making the individual consider properly the costs of a longer duration of unemployment and of a job with a greater risk of unemployment. One possible way of shifting the experience rating would be to calculate a reserve ratio for each individual. The individual reserve ratio would be defined in the same way that it now is for employers: the difference between the cumulative contributions made and the cumulative benefits received by that individual, divided by the individual's recent covered earnings.[20] Each individual would have a prescribed contribution level based on his current reserve ratio. With individual experience rating it would be necessary to have a maximum rate of contribution.

There are a variety of possible ways to finance these contributions. One possibility would be to require that employers pay the maximum rate of contribution for each employee with the provision that the employee receives, as a wage supplement, the difference betwen the maximum tax and the contribution that is required on the basis of his own reserve ratio. A wage supplement based on the individual's past experience would have the effect of rewarding workers who have had shorter durations of unemployment and encouraging individuals to seek more stable employment.

Under this individual experience plan, an unemployed worker would receive benefits just as he does now.[21] However, the longer he remains unemployed, the more his own reserve position would fall. When he returns to work, he would receive no wage supplement or a reduced supplement until his reserve ratio reached the appropriate level. The individual experience plan in effect provides an opportunity for an unemployed person to borrow against his future earnings (at a zero rate of interest). Because the individual will repay these benefits, it should be possible to raise the benefit

[20] The additional administrative costs would be small in comparison to the advantages. Only two additional numbers, cumulative contributions made and cumulative benefits received, would have to be added to the individual's Social Security record.

[21] The individual experience plan does not eliminate the desirability of taxing unemployment benefits.

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rate in each income class and to increase the maximum benefit. Other special features, such as allowing workers to withdraw a lump-sum amount to pay for moving expenses or to cover the costs of tuition in a private training program or educational institution, should also be possible. In short, by introducing individual experience rating into our current system, unemployment compensation can provide greater security without the current harmful disincentives.

There are, of course, a number of problems that would have to be solved in the design of a practical individual experience plan. Benefits would have to continue even after an individual's reserve is exhausted. Moreover, he must not be permitted to have such a large negative reserve ratio that there is no incentive for him to try to raise his reserve position. Some provision must also be made to reward retiring workers who have accumulated positive reserves. But these and other problems could be solved by balancing the objectives of income security and improved incentives. The result of doing so can be a more efficient economy and a much lower rate of unemployment.

Reducing the rate of unemployment

All the analysis in the current study supports the conclusion that our permanent rate of unemployment can be lowered substantially without inducing an unacceptable rate of inflation. It is important to recognize, however, that macroeconomic policy is unlikely to lower the permanent rate of unemployment much below the 4.5 per cent that has prevailed during the post-War period. Nevertheless, a series of specific policies could reduce the unemployment rate for those seeking permanent full-time employment to a level significantly below three per cent and perhaps closer to two per cent.

Speeding the absorption of young workers into employment and stabilizing their employment through better on-the-job training could lower the overall unemployment rate by at least 0.5 per cent. The current minimum wage law prevents many young people from obtaining jobs with low pay but valuable experience. Reducing the minimum wage for young workers might be useful but it would not be sufficient. A more effective policy would emphasize Youth Employment Scholarships that temporarily supplement earnings and allow young workers to "buy" better on-the-job training.

Better management of aggregate demand has a more important

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role to play in lowering adult unemployment than in improving the teenage employment situation. Nevertheless, even here macroeconomic policy can only achieve a small part of the total possible reduction in unemployment. The current system of unemployment compensation encourages excessive delays in returning to work. It also provides both employers and employees with the incentive to organize production in a way that increases the level of unemployment by making the seasonal and cyclical variation in unemployment too large and by making temporary jobs too common. A restructuring of the unemployment compensation system could reduce the unemployment resulting from cyclical and seasonal instability and from unnecessarily long durations between jobs by an additional 1.25 per cent or more. Further desirable reductions in unemployment could be achieved by subsidizing wages or incomes for handicapped workers and others with very low skills. There is, in short, no reason to allow the high average rate of unemployment that has prevailed in the post-War period to continue in the future.

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Managing the public service institution

PETER F. DRUCKER

SERVICE institutions are an increasingly important part of our society. Schools and universities; research laboratories; public utilities; hospitals and other health-care institutions; professional, industry, and trade associations; and many others—all these are as much "institutions" as is the business firm, and, therefore, are equally in need of management.[1] They all have people who are designated to exercise the management function and who are paid for doing the management job—even though they may not be called "managers," but "administrators," "directors," "executives," or some other such title.

These "public service" institutions—to give them a generic name—are the real growth sector of a modern society. Indeed, what we have now is a "multi-institutional" society rather than a "business" society. The traditional title of the American college course still tends to read "Business and Government." But this is an anachronism. It should read "Business, Government, and Many Others."

All public service institutions are being paid for out of the eco-

[1] Government agencies and bureaus are also "service institutions," of course, and have management problems which are comparable to those of the institutions I have mentioned. But because they also partake of a general "governmental" purpose, not usefully defined in management terms, I shall not be dealing with them in this article. I shall feel free, however, to include such quasi-governmental organizations as the TVA or the post office in my discussion.

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nomic surplus produced by economic activity. The growth of the service institutions in this century is thus the best testimonial to the success of business in discharging its economic task. Yet unlike, say, the early 19th-century university, the service institutions are not mere "luxury" or "ornament." They are, so to speak, main pillars of a modern society, load-bearing members of the main structure. They *have* to perform if society and economy are to function. It is not only that these service institutions are a major expense of a modern society; half of the personal income of the United States (and of most of the other developed countries) is spent on public service institutions (including those operated by the government). Compared to these "public service" institutions, both the "private sector" (i.e., the economy of goods) and the traditional government functions of law, defense, and public order, account for a smaller share of the total income flow of today's developed societies than they did around 1900—despite the cancerous growth of military spending.

Every citizen in the developed, industrialized, urbanized societies depends for his very survival on the performance of the public service institutions. These institutions also embody the values of developed societies. For it is in the form of education and health care, knowledge and mobility—rather than primarily in the form of more "food, clothing, and shelter"—that our society obtains the fruits of its increased economic capacities and productivity.

Yet the evidence for performance in the service institutions is not impressive, let alone overwhelming. Schools, hospitals, universities are all big today beyond the imagination of an earlier generation. They all dispose of astronomical budgets. Yet everywhere they are "in crisis." A generation or two ago, their performance was taken for granted. Today, they are being attacked on all sides for lack of performance. Services which the 19th century managed with aplomb and apparently with little effort—the postal service, for instance—are deeply in the red, require enormous and ever-growing subsidies, and yet give poorer service everywhere. In every country the citizen complains ever more loudly of "bureaucracy" and mismanagement in the institutions that are supposed to serve him.

Are service institutions manageable?

The response of the service institutions to this criticism has been to become "management conscious." They increasingly turn to business to learn "management." In all service institutions, "manager development," "management by objectives," and many other concepts

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and tools of business management are becoming increasingly popular. This is a healthy sign—but no more than that. It does not mean that the service institutions understand the problems of managing themselves. It only means that they have begun to realize that, at present, they are not being managed.

Yet, though "performance" in the public service institutions is the exception rather than the rule, the exceptions do prove that service institutions can perform. Among American public service agencies of the last 40 years, for instance, there is the Tennessee Valley Authority (TVA), the big regional electric-power and irrigation project in the Southeastern United States. (TVA's performance was especially notable during its early years, in the 1930's and 1940's, when it was headed by David Lilienthal.) While a great many—perhaps most—schools in the inner-city, black ghettos of America deserve all the strictures of the "deschooling" movement, a few schools in the very worst ghettos (e.g., in New York's South Bronx) have shown high capacity to make the most "disadvantaged" children acquire the basic skills of literacy.

What is it that the few successful service institutions do (or eschew) that makes them capable of performance? This is the question to ask. And it is a *management* question—of a special kind. In most respects, the service institution is not very different from a business enterprise. It faces similar—if not precisely the same—challenges in seeking to make work productive. It does not differ significantly from a business in its "social responsibility." Nor does the service institution differ very much from business enterprise in respect to the manager's work and job, in respect to organizational design and structure, or even in respect to the job and structure of top management. *Internally,* the differences tend to be differences in terminology rather than in substance.

But the service institution is in a fundamentally different "business" from business. It is different in its purpose. It has different values. It needs different objectives. And it makes a different contribution to society. "Performance and results" are quite different in a service institution from what they are in a business. "Managing for performance" is the one area in which the service institution differs significantly from a business.

Why service institutions do not perform

There are three popular explanations for the common failure of service institutions to perform:

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1) Their managers aren't "businesslike";
2) They need "better men";
3) Their objectives and results are "intangible."

All three are alibis rather than explanations.

1) The service institution will perform, it is said again and again, if only it is managed in a "businesslike" manner. Colbert, the great minister of Louis XIV, was the first to blame the performance difficulties of the non-business, the service institution, on this lack of "businesslike" management. Colbert, who created the first "modern" public service in the West, never ceased to exhort his officials to be "businesslike." The cry is still being repeated every day—by chambers of commerce, by presidential and royal commissions, by ministers in the Communist countries, and so on. If only, they all say, their administrators were to behave in a "businesslike" way, service institutions would perform. And of course, this belief also underlies, in large measure, today's "management boom" in the service institutions.

But it is the wrong diagnosis; and being "businesslike" is the wrong prescription for the ills of the service institution. The service institution has performance trouble precisely because it is *not* a business. What being "businesslike" usually means in a service institution is little more than control of cost. What characterizes a business, however, is focus on results—return on capital, share of market, and so on.

To be sure, there is a need for efficiency in all institutions. Because there is usually no competition in the service field, there is no outward and imposed cost control on service institutions as there is on business in a competitive (and even an oligopolistic) market. But the basic problem of service institutions is not high cost but lack of effectiveness. They may be very efficient—some are. But they then tend not to do the right things.

The belief that the public service institution will perform if only it is put on a "businesslike" basis underlies the numerous attempts to set up many government services as separate "public corporations" —again an attempt that dates back to Colbert and his establishment of "Crown monopolies." There may be beneficial side effects, such as freedom from petty civil service regulation. But the intended main effect, performance, is seldom achieved. Costs may go down (though not always; setting up London Transport and the British Post Office as separate "businesslike" corporations, and thereby making them defenseless against labor union pressures, has led to skyrocketing costs). But services essential to the fulfillment of the institution's purpose may be slighted or lopped off in the name of "efficiency."

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The best and worst example of the "businesslike" approach in the public service institution may well be the Port of New York Authority, set up in the 1920's to manage automobile and truck traffic throughout the two-state area (New York and New Jersey) of the Port of New York. The Port Authority has, from the beginning, been "businesslike" with a vengeance. The engineering of its bridges, tunnels, docks, silos, and airports has been outstanding. Its construction costs have been low and under control. Its financial standing has been extremely high, so that it could always borrow at most advantageous rates of interest. It made being "businesslike"—as measured, above all, by its standing with the banks—its goal and purpose. As a result, it did not concern itself with transportation policy in the New York metropolitan area, even though its bridges, tunnels, and airports generate much of the traffic in New York's streets. It did not ask: "Who are our constituents?" Instead it resisted any such question as "political" and "unbusinesslike." Consequently, it has come to be seen as the villain of the New York traffic and transportation problem. And when it needed support (e.g., in finding a place to put New York's badly needed fourth airport), it found itself without a single backer, except the bankers. As a result the Port Authority may well become "politicized"; that is, denuded of its efficiency without gaining anything in effectiveness.

"Better people"

The cry for "better people" is even older than Colbert. In fact, it can be found in the earliest Chinese texts on government. In particular, it has been the constant demand of all American "reformers," from Henry Adams shortly after the Civil War, to Ralph Nader today. They all have believed that the one thing lacking in the government agency is "better people."

But service institutions cannot, any more than businesses, depend on "supermen" to staff their managerial and executive positions. There are far too many institutions to be staffed. If service institutions cannot be run and managed by men of normal—or even fairly low—endowment, if, in other words, we cannot organize the task so that it will be done on a satisfactory level by men who only try hard, it cannot be done at all. Moreover, there is no reason to believe that the people who staff the managerial and professional positions in our "service" institutions are any less qualified, any less competent or honest, or any less hard-working than the men who manage businesses. By the same token, there is no reason to believe that business

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managers, put in control of service institutions, would do better than the "bureaucrats." Indeed, we know that they immediately become "bureaucrats" themselves.

One example of this was the American experience during World War II, when large numbers of business executives who had performed very well in their own companies moved into government positions. Many rapidly became "bureaucrats." The men did not change. But whereas in business they had been capable of obtaining performance and results, in government they found themselves producing primarily procedures and red tape—and deeply frustrated by the experience.

Similarly, effective businessmen who are promoted to head a "service staff" within a business (e.g., the hard-hitting sales manager who gets to be "Vice President—marketing services") tend to become "bureaucrats" almost overnight. Indeed, the "service institutions" within business—R&D departments, personnel staffs, marketing or manufacturing service staffs, and the like—apparently find it just as hard to perform as the public service institutions of society at large, which businessmen often criticize as being "unbusinesslike" and run by "bureaucrats."

"Intangible" objectives

The most sophisticated and, at first glance, the most plausible explanation for the non-performance of service institutions is the last one: The objectives of service institutions are "intangible," and so are their results. This is at best a half-truth.

The definition of what "our business is" is always "intangible," in a business as well as in a service institution. Surely, to say, as Sears Roebuck does, "Our business is to be the informed buyer for the American family," is "intangible." And to say, as Bell Telephone does, "Our business is service to the customers," may sound like a pious and empty platitude. At first glance, these statements would seem to defy any attempt at translation into operational, let alone quantitative, terms. To say, "Our business is electronic entertainment," as Sony of Japan does, is equally "intangible," as is IBM's definition of its business as "data processing." Yet, as these businesses have clearly demonstrated it is not exceedingly difficult to derive concrete and measurable goals and targets from "intangible" definitions like those cited above.

"Saving souls," as the definition of the objectives of a church is, indeed, "intangible." At least the bookkeeping is not of this world.

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But church attendance is measurable. And so is "getting the young people back into the church."

"The development of the whole personality" as the objective of the school is, indeed, "intangible." But "teaching a child to read by the time he has finished third grade" is by no means intangible; it can be measured easily and with considerable precision.

"Abolishing racial discrimination" is equally unamenable to clear operational definition, let alone measurement. But to increase the number of black apprentices in the building trades is a quantifiable goal, the attainment of which can be measured.

Achievement is never possible except against specific, limited, clearly defined targets, in business as well as in a service institution. Only if targets are defined can resources be allocated to their attainment, priorities and deadlines be set, and somebody be held accountable for results. But the starting point for effective work is a definition of the purpose and mission of the institution—which is almost always "intangible," but nevertheless need not be vacuous.

It is often said that service institutions differ from businesses in that they have a plurality of constituencies. And it is indeed the case that service institutions have a great many "constitutents." The school is of vital concern not only to children and their parents, but also to teachers, to taxpayers, and to the community at large, Similarly, the hospital has to satisfy the patient, but also the doctors, the nurses, the technicians, the patient's family—as well as taxpayers or, as in the United States, employers and labor unions who through their insurance contributions provide the bulk of the support of most hospitals. But business also has a plurality of constituencies. Every business has at least two different customers, and often a good many more. And employees, investors, and the community at large—and even management itself—are also "constituencies."

Misdirection by budget

The one basic difference between a service institution and a business is the way the service institution is paid. Businesses (other than monopolies) are paid for satisfying the customer. They are only paid when they produce what the customer wants and what he is willing to exchange his purchasing power for. Satisfaction of the customer is, therefore, the basis for performance and results in a business.

Service institutions, by contrast, are typically paid out of a budget allocation. Their revenues are allocated from a general revenue stream that is not tied to what they are doing, but is obtained by tax,

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levy, or tribute. Furthermore, the typical service institution is endowed with monopoly powers; the intended beneficiary usually has no choice.

Being paid out of a budget allocation changes what is meant by "performance" or "results." *"Results" in the budget-based institution means a larger budget. "Performance" is the ability to maintain or to increase one's budget.* The first test of a budget-based institution and the first requirement for its survival is to obtain the budget. And the budget is, by definition, related not to the achievement of any goals, but to the *intention* of achieving those goals.

This means, first, that efficiency and cost control, however much they are being preached, are not really considered virtues in the budget-based institution. The importance of a budget-based institution is measured essentially by the size of its budget and the size of its staff. To achieve results with a smaller budget or a smaller staff is, therefore, not "performance." It might actually endanger the institution. Not to spend the budget to the hilt will only convince the budget-maker—whether a legislature or a budget committee—that the budget for the next fiscal period can safely be cut.

Thirty or 40 years ago, it was considered characteristic of Russian planning, and one of its major weaknesses, that Soviet managers, towards the end of the plan period, engaged in a frantic effort to spend all the money allocated to them, which usually resulted in total waste. Today, the disease has become universal, as budget-based institutions have become dominant everywhere. And "buying-in"—that is, getting approval for a new program or project by grossly underestimating its total cost—is also built into the budget-based institution.

"Parkinson's Law" lampooned the British Admiralty and the British Colonial Office for increasing their staffs and their budgets as fast as the British Navy and the British Empire went down. "Parkinson's Law" attributed this to inborn human perversity. But it is perfectly rational behavior for someone on a budget, since it is the budget, after all, that measures "performance" and "importance."

It is obviously not compatible with *efficiency* that the acid test of performance should be to obtain the budget. But *effectiveness* is even more endangered by reliance on the budget allocation. It makes it risky to raise the question of what the "business" of the institution should be. That question is always "controversial"; such controversy is likely to alienate support and will therefore be shunned by the budget-based institution. As a result, it is likely to wind up deceiving both the public and itself.

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Take an instance from government: The U.S. Department of Agriculture has never been willing to ask whether its goal should be "farm productivity" or "support of the small family farm." It has known for decades that these two objectives are not identical as had originally been assumed, and that they are, indeed, becoming increasingly incompatible. To admit this, however, would have created controversy that might have endangered the Department's budget. As a result, American farm policy has frittered away an enormous amount of money and human resources on what can only (and charitably) be called a public relations campaign, that is, on a show of support for the small family farmer. The effective activities, however—and they have been very effective indeed—have been directed toward eliminating the small family farmer and replacing him by the far more productive "agribusinesses," that is, highly capitalized and highly mechanized farms, run as a business and not as a "way of life." This may well have been the right thing to do. But it certainly was not what the Department was founded to do, nor what the Congress, in approving the Department's budget, expected it to do.

Take a non-governmental example, the American community hospital, which is "private" though "non-profit." Everywhere it suffers from a growing confusion of missions and objectives, and the resulting impairment of its effectiveness and performance. Should a hospital be, in effect, a "physician's facility"—as most older American physicians still maintain? Should it focus on the major health needs of a community? Or should it try to do everything and be "abreast of every medical advance," no matter what the cost and no matter how rarely certain facilities will be used? Should it devote resources to preventive medicine and health education? Or should it, like the hospital under the British health service, confine itself strictly to repair of major health damage after it has occurred?

Every one of these definitions of the "business" of the hospital can be defended. Every one deserves a hearing. The effective American hospital will be a multi-purpose institution and strike a balance between various objectives. What most hospitals do, however, is pretend that there are no basic questions to be decided. The result, predictably, is confusion and impairment of the hospital's capacity to serve any function and to carry out any mission.

Pleasing everyone and achieving nothing

Dependence on a budget allocation militates against setting priorities and concentrating efforts. Yet nothing is ever accomplished un-

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less scarce resources are concentrated on a small number of priorities. A shoe manufacturer who has 22 per cent of the market for work shoes may have a profitable business. If he succeeds in raising his market share to 30 per cent, especially if the market for his kind of footwear is expanding, he is doing very well indeed. He need not concern himself too much with the 78 per cent of the users of work shoes who buy from somebody else. And the customers for ladies' fashion shoes are of no concern to him at all.

Contrast this with the situation of an institution on a budget. To obtain its budget, it needs the approval, or at least the acquiescence, of practically everybody who remotely could be considered a "constituent." Where a market share of 22 per cent might be perfectly satisfactory to a business, a "rejection" by 78 per cent of its "constituents"—or even by a much smaller proportion—would be fatal to a budget-based institution. And this means that the service institution finds it difficult to set priorities; it must instead try to placate everyone by doing a little bit of everything—which, in effect, means achieving nothing.

Finally, being budget-based makes it even more difficult to abandon the wrong things, the old, the obsolete. As a result, service institutions are even more encrusted than businesses with the barnacles of inherently unproductive efforts.

No institution likes to abandon anything it does. Business is no exception. But in an institution that is being paid for its performance and results, the unproductive, the obsolete, will sooner or later be killed off by the customers. In a budget-based institution no such discipline is being enforced. The temptation is great, therefore, to respond to lack of results by redoubling efforts. The temptation is great to double the budget, precisely *because* there is no performance.

Human beings will behave as they are rewarded for behaving—whether the reward be money and promotion, a medal, an autographed picture of the boss, or a pat on the back. This is one lesson the behavioral psychologist has taught us during the last 50 years (not that it was unknown before). A business, or any institution that is paid for its results and performance in such a way that the dissatisfied or disinterested customer need not pay, has to "earn" its income. An institution that is financed by a budget—or that enjoys a monopoly which the customer cannot escape—is rewarded for what it "deserves" rather than for what it "earns." It is paid for good intentions and for "programs." It is paid for not alienating important constituents rather than for satisfying any one group. It is mis-

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directed, by the way it is paid, into defining "performance" and "results" as what will maintain or increase its budget.

What works

The exception, the comparatively rare service institution that achieves effectiveness, is more instructive than the great majority that achieves only "programs." It shows that effectiveness in the service institution is achievable—though by no means easy. It shows what different kinds of service institutions can do and need to do. It shows limitations and pitfalls. But it also shows that the service institution manager can do unpopular and highly "controversial" things if only he makes the risk-taking decision to set priorities and allocate resources.

The first and perhaps simplest example is that of the Bell Telephone System. A telephone system is a "natural" monopoly. Within a given area, one supplier of telephone service must have exclusive rights. The one thing any subscriber to a public telephone service requires is access to all other subscribers, which means territorial exclusivity for one monopolistic service. And as a whole country or continent becomes, in effect, one telephone system, this monopoly has to be extended over larger and larger areas.

An individual may be able to do without a telephone—though in today's society only at prohibitive inconvenience. But a professional man, a tradesman, an office, or a business *must* have a telephone. Residential phone service may still be an "option." Business phone service is compulsory. Theodore Vail, the first head of the organization, saw this in the early years of this century. He also saw clearly that the American telephone system, like the telephone systems in all other industrially developed nations, could easily be taken over by government. To prevent this, Vail thought through what the telephone company's business was and should be, and came up with his famous definition: "Our business is service."[2] This totally "intangible" statement of the telephone company's "business" then enabled Vail to set specific goals and objectives and to develop measurements of performance and results. His "customer satisfaction" standards and "service satisfaction" standards created nationwide competition between telephone managers in various areas, and became the criteria

[2] This was so heretical that the directors of the telephone company fired Vail when he first propounded his thesis in 1897—only to rehire him 10 years later when the absence of clear performance objectives had created widespread public demand for telephone nationalization even among such non-radicals as the Progressive wing of the Republican Party.

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by which the managers were judged and rewarded. These standards measured performance as defined by the customer, e.g., waiting time before an operator came on the line, or time between application for telephone service and its installation. They were meant to direct managers' attention to results.

Vail also thought through who his "constituents" were. This led to his conclusion—even more shocking to the conventional wisdom of 1900 than his "service" objectives—that it was the telephone company's task to make the public utility commissions of the individual states capable of effective rate regulation. Vail argued that a national monopoly in a crucial area could expect to escape nationalization only by being regulated. Helping to convert the wretchedly ineffectual, corrupt, and bumbling public utility commissions of late 19th-century populism into effective, respected, and informed adversaries was in the telephone company's own survival interest.

Finally, Vail realized that a telephone system depends on its ability to obtain capital. Each dollar of telephone revenue requires a prior investment of three to four dollars. Therefore, the investor too had to be considered a "constituent," and the telephone company had to design financial instruments and a financial policy that focused on the needs and expectations of the investor, and that made telephone company securities, whether bonds or shares, a distinct and preferred financial "product."

The American university

The building of the American university from 1860 to World War I also illustrates how service institutions can be made to perform. The American university as it emerged during that era was primarily the work of a small number of men: Andrew D. White (President of Cornell, 1868-1885); Charles W. Eliot (President of Harvard, 1869-1909); Daniel Coit Gilman (President of Johns Hopkins, 1876-1901); David Starr Jordan (President of Stanford, 1891-1913); William Rainey Harper (President of Chicago, 1892-1904); and Nicholas Murray Butler (President of Columbia, 1902-1945).

These men all had in common one basic insight: The traditional "college"—essentially an 18th–century seminary to train preachers—had become totally obsolete, sterile, and unproductive. Indeed, it was dying fast; America in 1860 had far fewer college students than it had had 40 years earlier with a much smaller population. The men who built the new universities shared a common objective: to create a new institution, a true "university." And they all realized that while

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European examples, especially Oxford and Cambridge and the German university, had much to offer, these new universities had to be distinctively American institutions.

Beyond these shared beliefs, however, they differed sharply on what a university should be and what its purpose and mission were. Eliot, at Harvard, saw the purpose of the university as that of educating a leadership group with a distinct "style." His Harvard was to be a "national" institution rather than the parochial preserve of the "proper Bostonian" that Harvard College had been. But it also was to restore to Boston—and to New England generally—the dominant position of a moral elite, such as in earlier times had been held by the "Elect," the Puritan divines, and their successors, the Federalist leaders in the early days of the Republic. Butler, at Columbia—and, to a lesser degree, Harper at Chicago—saw the function of the university as the systematic application of rational thought and analysis to the basic problems of a modern society, from education to economics, and from domestic government to foreign affairs. Gilman, at Johns Hopkins, saw the university as the producer of advanced knowledge; indeed, originally Johns Hopkins was to confine itself to advanced research and was to give no undergraduate instruction. White, at Cornell, aimed at producing an "educated public."

Each of these men knew that he had to make compromises. Each knew that he had to satisfy a number of "constituencies" and "publics," each of whom looked at the university quite differently. Both Eliot and Butler, for instance, had to build their new university on an old foundation (the others could build from the ground up) and had to satisfy—or at least to placate—existing alumni and faculty. They all had to be exceedingly conscious of the need to attract and hold financial support. It was Eliot, for instance, with all his insistence on "moral leadership," who invented the first "placement office" and set out to find well-paying jobs for Harvard graduates, especially in business. It was Butler, conscious that Columbia was a late-comer and that the millionaire philanthropists of his day had already been snared by his competitors (e.g., Rockefeller by Chicago), who invented the first "public relations" office in a university, designed—and most successfully—to reach the merely well-to-do and get their money.

These founders' definitions did not outlive them. Even during the lifetime of Eliot and Butler, for instance, their institutions escaped their control, began to diffuse objectives and to confuse priorities. In the course of this century, all these universities—and many others, like the University of California and other major state universities—

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have converged towards a common type. Today, it is hard to tell one "multiversity" from another. Yet the imprint of the founders has still not been totally erased. It is hardly an accident that the New Deal picked faculty members primarily from Columbia and Chicago to be high-level advisors and policy makers; for the New Deal was, of course, committed to the application of rational thought and analysis to public policies and problems. And 30 years later, when the Kennedy Administration came in with an underlying belief in the "style" of an "elite," it naturally turned to Harvard. For while each of the founding fathers of the modern American university made compromises and adapted to a multitude of constituencies, each had an objective and a definition of the university to which he gave priority and against which he measured performance. Clearly, the job the founders did almost a century ago will have to be done again for today's "multiversity," if it is not to choke on its own services.

Schools, hospitals, and the TVA

The English "open classroom" is another example of a successful service institution. It is being promoted in this country as the "child-centered" approach to schooling, but its origin was in the concern with performance, and that is also the secret of its success. The English "open classroom" demands that each child—or at least each normal child—acquire the same measurable proficiency in the basic skills of literacy at roughly the same time. It is then the teacher's task to think through the learning path best suited to lead each child to a common and pre-set goal. The objectives are perfectly clear: the learning of specific skills, especially reading, writing, and figuring. They are identical for all children, measurable, and measured. Everything else is, in effect, considered irrelevant. Such elementary schools as have performed in the urban slums of this country—and there are more of them than the current "crisis in the classroom" syndrome acknowledges—have done exactly the same thing. The performing schools in black or Puerto Rican neighborhoods in New York, for instance, are those that have defined one clear objective—usually to teach reading—have eliminated or subordinated everything else, and then have measured themselves against a standard of clearly set performance goals.

The solution to the problem of the hospital, as is becoming increasingly clear, will similarly lie in thinking through objectives and priorities. The most promising approach may well be one worked out by the Hospital Consulting Group at Westinghouse Electric Corpo-

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ration, which recognizes that the American hospital has a multiplicity of functions, but organizes each as an autonomous "decentralized" division with its own facilities, its own staff, and its own objectives. There would thus be a traditional care hospital for the fairly small number of truly sick people who require what today's "full-time" hospital offers; an "ambulatory" medical hospital for diagnosis and out-patient work; an "ambulatory" surgical hospital for the large number of surgical patients—actually the majority—who, like patients after cataract surgery, a tonsilectomy, or most orthopedic surgery, are not "sick" and need no medical and little nursing care, but need a bed (and a bedpan) till the stitches are firm or the cast dries; a psychiatric unit—mostly for out-patient or overnight care; and a convalescent unit that would hardly differ from a good motel (e.g., for the healthy mother of a healthy baby). All these would have common services. But each would be a separate health care facility with different objectives, different priorities, and different standards of performance.

But the most instructive example of an effective service institution may be that of the early Tennessee Valley Authority. Built mainly during the New Deal, the TVA today is no longer "controversial." It is just another large power company, except for being owned by the government rather than by private investors. But in its early days, 40 years ago, the TVA was a slogan, a battle cry, a symbol. Some, friends and enemies alike, saw in it the opening wedge of the nationalization of electric energy in the United States. Others saw in it the vehicle for a return to Jeffersonian agrarianism, based on cheap power, government paternalism, and free fertilizer. Still others were primarily interested in flood control and navigation. Indeed, there was such a wealth of conflicting expectations that TVA's first head, Arthur Morgan, a distinguished engineer and economist, completely floundered. Unable to think through what the business of the TVA should be and how varying objectives might be balanced, Morgan accomplished nothing. Finally, President Roosevelt replaced him with an almost totally unknown young lawyer, David Lilienthal, who had little previous experience as an administrator.

Lilienthal faced up to the need to define the TVA's business. He concluded that the first objective was to build truly efficient electric plants and to supply an energy-starved region with plentiful and cheap power. All the rest, he decided, hinged on the attainment of this first need, which then became his operational priority. The TVA of today has accomplished a good many other objectives as well,

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from flood control and navigation to fertilizer production and, indeed, even balanced community development. But it was Lilienthal's insistence on a clear definition of the TVA's business and on setting priorities that explains why today's TVA is taken for granted, even by the very same people who, 40 years ago, were among its implacable enemies.

The requirements for success

Service institutions are a most diverse lot. The one and only thing they all have in common is that, for one reason or another, they cannot be organized under a competitive market test.[3] But however diverse the various kinds of "service institutions" may be, all of them need first to impose on themselves the discipline practiced by the managers and leaders of the institutions in the examples presented above.

1) They need to answer the question, "*What is our business and what should it be?*" They need to bring out into the open alternative definitions and to think them through carefully, perhaps even to work out (as did the presidents of the emerging American universities) the balance of different and sometimes conflicting definitions. What service institutions need is not to be more "business-like." They need to be more "hospital-like," "university-like," "government-like," and so on. They need to be subjected to a performance test—if only to that of "socialist competition"—as much as possible. In other words, they need to think through their own specific function, purpose, and mission.

2) Service institutions need to derive *clear objectives and goals* from their definition of function and mission. What they need is not "better people," but people who do the management job systematically and who focus themselves and their institutions purposefully on performance and results. They do need efficiency—that is, control of costs. But, above all, they need effectiveness—that is, emphasis on the right results.

3) They then have to think through *priorities* of concentration which enable them to select targets; to set standards of accomplishment and performance (that is, to define the minimum acceptable

[3] This may no longer be necessarily true for the postal service. At last an independent postal company in the U.S. is trying to organize a business in competition to the government's postal monopoly. Should this work out, it might do more to restore performance to the mails than the recent setting up of a postal monopoly as a separate "public corporation" which is on a "businesslike" basis.

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results); to set deadlines; to go to work on results; and to make someone accountable for results.

4) They need to define *measurements of performance*—the "customer satisfaction" measurements of the telephone company, or the figures on reading performance by which the English "open classroom" measures its accomplishments.

5) They need to use these measurements to *"feed back"* on their efforts—that is, *they must build self-control from results into their system.*

6) Finally, they need an organized audit of *objectives and results,* so as to identify those objectives that no longer serve a useful purpose or have proven unattainable. They need to identify unsatisfactory performance, and activities which are obsolete, unproductive, or both. And they need a mechanism for *sloughing off* such activities rather than wasting their money and their energies where the results are not.

This last requirement may be the most important one. The absence of a market test removes from the service institution the discipline that forces a business eventually to abandon yesterday's products—or else go bankrupt. Yet this requirement is the least understood.

No success lasts "forever." Yet it is even more difficult to abandon yesterday's success than it is to reappraise failure. Success breeds its own *hubris.* It creates emotional attachments, habits of thought and action, and, above all, false self-confidence. A success that has outlived its usefulness may, in the end, be more damaging than failure. Especially in a service institution, yesterday's success becomes "policy," "virtue," "conviction," if not indeed "Holy Writ," unless the institution imposes on itself the discipline of thinking through its mission, its objectives, and its priorities, and of building in feedback control from results over policies, priorities, and action. We are in such a "welfare mess" today in the United States largely because the welfare program of the New Deal had been such a success in the 1930's that we could not abandon it, and instead misapplied it to the radically different problem of the black migrants to the cities in the 1950's and 1960's.

To make service institutions perform, it should by now be clear, does not require "great men." It requires instead a system. The essentials of this system may not be too different from the essentials of performance in a business enterprise, as the present "management boom" in the service institutions assumes. But the application will be quite different. For the service institutions are

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not businesses; "performance" means something quite different for them.

Few service institutions today suffer from having too few administrators; most of them are over-administered, and suffer from a surplus of procedures, organization charts, and "management techniques." What now has to be learned—it is still largely lacking—is to manage service institutions for performance. This may well be the biggest and most important management task for the remainder of this century.

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What welfare crisis? —a comparison among the United States, Britain, and Sweden

MARTIN REIN & HUGH HECLO

For more than a decade Americans have lamented their welfare crisis. Costs have tripled since 1960. The welfare population has climbed inexorably. Aid for Dependent Children (AFDC) is accepted as the symbol for social disintegration and family problems among the poor. By 1972 the number of its recipients had risen fivefold since the mid-1950's, doubling just since 1967; the average *annual* rate of increase in AFDC recipients jumped from 7.3 per cent during 1953-66 to 18.3 per cent during 1967-71. Such estimates of mushrooming welfare rates led Congress and the Executive to conclude that, far from curing economic dependency, American welfare programs have only spread the "disease." They alleged that here is a system which fails both those who receive and those who pay. The extent of welfare growth amid affluence is perceived as a standing indictment: Something must be wrong with the program and its recipients. Worse, something must be wrong with American society itself.

We have no intention of suggesting that there is cause for complacency. Mess is the most appropriate term for much of this nation's public assistance system. What we do hope to offer is a more balanced perspective on American welfare. By comparing costs, re-

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cipient rates, and composition of welfare populations in several affluent countries, we will contend that the so-called welfare crisis is *not* distinctively American with respect to these characteristics. What is distinctive is our response to them. The welfare "problem" as currently posed in America is insoluble and one which reformers would be prudent to redefine.

The components of welfare spending

First, let us look at the "burden" of costs. Welfare, or public assistance, tends to be identified in the United States with cash relief payments—not Social Security, not veterans' payments, not unemployment insurance. "Welfare" is considered as the money grants people receive when they are destitute and have no claim, through insurance or veteran status, to public funds. Although the actual situation is far more complex (over one million Social Security recipients, for example, also receive "welfare" via Old Age Assistance), it is the payment of cash living expenses to welfare clients that is regarded as particularly worrisome. Yet such cash relief payments in 1972 accounted for only half of all public assistance costs, and the proportion has recently been declining. The official definition of public assistance also includes Medicaid, social services, and the administrative costs for running all of these programs. It excludes the family of related means-tested benefits such as food stamps, public housing, free school lunches, and the like. In this paper we consider only the official definition, since it is the publicity given to these figures, rather than to the totals for all income-tested programs, which has been associated with a sense of welfare crisis.

Welfare financing is divided among federal, state, and local governments. Because the same local welfare department is likely to administer all public assistance programs (and in some instances other programs as well), there is a tendency to blur the distinctions in reporting aggregate data. Often reports of expenditures lump together Medicaid and cash relief payments to individuals, while the size of administrative outlays, including spending for social services, is indicated only in special reports. Thus the cash relief picture is greatly distorted by considering only *total* public assistance costs, which for FY 1972 were $22.4 billion. Disaggregating this total shows 50 per cent ($11.2 billion) going for cash assistance payments and 35 per cent ($7.9 billion) for Medicaid. The remaining 15 per cent ($3.7 billion) was labeled administrative costs, but was further divided up among social services (9.7 per cent, $2.2 billion), training (0.2 per

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cent, $45 million), and administration (4.7 per cent, $1.1 billion) for these programs. Cash relief payments to individuals, which had been 54 per cent in 1970, had declined to half the public assistance budget in 1972.[1]

Distinctions among expenditure components are important for clarifying the size, growth, and explanation of the public assistance "burden." Direct cash payments have shown rapid growth: By the end of 1972 almost 15 million Americans were receiving cash relief grants at an annual cost of $11.2 billion; these figures represent twice the number of clients and more than three times the costs of a decade earlier (from $3.5 billion in 1962 to $11.2 billion in 1972). *But the greatest increase in public assistance costs since the mid-1960's has come from Medicaid and social services, not from relief payments.* The costs of Medicaid (and its earlier counterparts in welfare) between 1962 and 1972 jumped from $0.9 billion to $8.1 billion. Social services expenditures in 1973 were seven times ($3.3 billion) the spending in 1969. Thus despite the publicized shift from a "services" to an "income" strategy which supposedly marked the advent of the Nixon administration, services continued to increase more rapidly than cash relief.

One reason for distinguishing Medicaid from direct cash payment —aside from the fact that it is doctors, druggists, and hospitals, not welfare clients, who get Medicaid money—is that not all persons obtaining Medicaid receive cash relief. In 1970, one quarter of the 16.4 million Medicaid recipients did not receive any cash relief payments, and they accounted for an estimated 37 per cent of total Medicaid costs. Poor persons, and some not so poor, are particularly vulnerable to the threat posed by high medical expenses, and it is such heavy costs that force them to rely on Medicaid. Secondly, the dynamics underlying increases in cash relief and in medical costs are not the same. The dramatic increase in Medicaid is best understood as the natural outcome of increasing the chances for effective demand to be expressed, while failing to alter significantly the supply of medical services or to impose adequate contraints on the medical fees charged. The costs of medical care in public assistance rose, not because American self-reliance and individualism was weakening, but because of a political judgment not to confront the vested interests in the medical care field. Medicaid spending goes to medical professionals; it is not a cost which the poor have any choice about—

[1] These figures for earlier years are reported in National Center for Social Statistics, *Expenditure for Public Assistance Payments and Other Costs*, F5 Report. Estimates for 1972 were provided by the Regional Office of HEW.

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except, of course, the choice of not seeking treatment when they are ill.

Social services are also different from cash payments. According to the legislation, social services were designed to promote "self-support and personal independence," and "in addition, to prevent or reduce dependency." It was this latter objective that Congress appeared to have in mind when, in 1962, it permitted states to receive reimbursement for 75 per cent of the costs of these services. But the major growth of social services costs has occurred in more recent years. In 1971 expenditures were a modest $761 million; by 1973 the President's budget projected outlays of $1.2 billion, while unofficial estimates made during July placed the figure at $4.7 billion. Alarmed by the projected increases, Congress enacted a ceiling of $2.5 billion in 1973.

Here again, the basic forces for expansion appear to have little to do with any American problem of personal dependency (except perhaps on the part of state officials eager to free state funds by increased dependence on national financing). The dramatic increase in social services spending is a function of administrative entrepreneurship—the result of the efforts of enterprising consultants, program analysts, state budget planners, and other officials who have sought to redefine and regroup programs so as to take advantage of open-ended sources of federal aid. Far from taking the form of increased handouts to an ever-burgeoning welfare population, such services spending has disappeared into the existing state budgets. That social services may, by and large, be "non-events" for the poor is suggested in a statement by Representative Martha Griffiths, the exasperated chairwoman of a Joint Economic Subcommittee: "No one has known on what the money was being spent and who was receiving the services." Growing Medicaid and social services costs ($10.1 billion in 1972) are not trivial issues. But neither are they indictments of welfare clients or American society. To confuse these administrative/political issues with the growth of social dependency is mischievous and muddling.

Recent trends in welfare expenditures

Let us concentrate on cash assistance to welfare clients and consider what "burdens" they have imposed on local, state, and federal budgets. Broadly speaking, about one half of total public assistance funds come from the federal government, about one third from the states, and the remainder from local governments. Approximately one third of local authorities do not participate at all in the financ-

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ing of public assistance, and among those local jurisdictions that do participate, contributions for cash relief (as a proportion of their own tax levies) are remarkably modest. New York City is usually taken as the example par excellence of the havoc created by welfare in local budgets. The following table sets out the proportion of local revenues actually absorbed by welfare in New York City. Outlays

TABLE 1. *Tax Levy Expenditures for Public Assistance in New York City*[1]

FISCAL YEAR	TOTAL TAX LEVY (IN MILLIONS)	TAX LEVY FOR PUBLIC ASSISTANCE (IN MILLIONS)	TAX LEVY FOR PUBLIC ASSISTANCE (AS A PER CENT OF TOTAL TAX LEVY)
1963-64	$2,310	$ 63.7	2.8
1964-65	2,485	77.2	3.1
1965-66	2,536	95.0	3.7
1966-67	2,985	129.1	4.3
1967-68	3,291	183.5	5.6
1968-69	3,688	267.9	7.3
1969-70	3,992	266.4	6.7
1970-71	4,253	315.1	7.4
1971-72	4,928	325.8	6.4
1972-73	5,494[2]	340.0[3]	6.1

[1] Source: Annual Report of the Comptroller of the City of New York for respective years.
[2] Expense Budget as adopted, FY 1972-73.
[3] Bureau of Budget Estimate based on expenditure in first 6 mo. of FY.

for relief payments obviously have risen considerably since the early 1960's. But two points stand out. First, what occurred was far from a runaway increase in the municipal fiscal burden; *even as the proportion peaked in FY 1970-71, the City spent only 7.4 per cent of its own tax levies for cash assistance payments.* Second, during the years subsequent to this high point, and while welfare was at the center of New York and national social policy debates, the fiscal burden on the local budget was slowly declining.

New York is, of course, far from representative of all cities, but it is usually taken as a major site of the welfare crisis, if only because the City absorbs slightly over one tenth of total national costs for cash relief. The national prominence of New York's welfare syndrome was epitomized in 1970 as the *New York Times* and other media headlined a shocking fact: For the first time in history, the City's welfare budget exceeded its education budget. What more dramatic proof of distorted spending priorities could one ask for? Yet closer examination of the data (Table 2) shows that the alarmist's landmark was largely an artifact created by implying that all expenditures grouped under the City's Department of Social Services (DSS) are cash welfare payments. In fact, the DSS budget includes outlays for child welfare, shelter services for adults, day care, and

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TABLE 2. *Education and Welfare Expense Budgets in New York City, All Funds*

FISCAL YEAR	BOARD OF EDUCATION (IN MILLIONS)	DEPARTMENT OF SOCIAL SERVICES TOTAL (IN MILLIONS)	DEPARTMENT OF SOCIAL SERVICES CASH RELIEF PAYMENTS (IN MILLIONS)
1967-68	$1,265	$ 954	$ 560
1968-69	1,471	1,384	835
1969-70	1,520	1,563	1,193
1970-71	1,841	1,766	1,095
1971-72	1,921	2,012	1,159
1972-73	2,114	2,225	1,176

other activities, including some Medicaid costs. *At no time in the past half-dozen years have costs for cash assistance exceeded the education budget;* in FY 1969-70, when the supposed milestone was reached, cash relief payments were about three quarters of the Board of Education budget; in 1967-68 the proportion had been 44 per cent; by 1972-73 it was estimated to be down to 55 per cent.[2] These facts may be distressing but they surely do not need to be exaggerated. Moreover, as far as the fiscal burden on the City is concerned, welfare cannot compare with education; local tax levy funds make up about 60 per cent of the municipal education budget but only 30 per cent of the welfare budget. In short, the 1970 story shows how grouping many other activities with welfare under one administrative structure can stigmatize all of the programs.

Does this mean the "burden" is really felt in state government expenditures? A neglected technical study prepared for the President's Commission on Income Maintenance examined the widely held view that welfare costs have produced a fiscal crisis for the states. The report concluded that the data are clearly inconsistent with that hypothesis: "The performance ratios[3] for the states . . . in Fiscal Year 1968, were slightly above their post-War lows. At eight per cent the state ratio is less than 58 per cent of its post-War high of 13.8 per cent reached in Fiscal Year 1950." Between 1966 and 1968 state expenditures did increase somewhat, but they still continued to represent "nothing more than a return to the average ratios of the preceding decade."

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[2] We wish to thank Joseph J. McGovern, program planner for the Bureau of the Budget in New York City, for his assistance with these figures.

[3] Performance ratios are defined as welfare expenditures from the state's own revenues, as a proportion of their own general revenues after federal reimbursements are taken into account. The quote is from Robert W. Rafuse, Jr., "Income Maintenance Programs and State Local Finances," in *President's Commission on Income Maintenance Programs Technical Studies,* p. 220-221.

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The federal share

The federal government carries the largest share of public assistance costs, and inasmuch as the 1972 amendments to the Social Security Act will nationalize spending for adult welfare categories (the aged, blind, and disabled), there is every likelihood it will continue to do so in the future. What then has been the relative burden of public assistance on the federal budget? Between 1950 and 1970 federal expenditure for public assistance (AFDC plus aid for the aged, disabled, and blind) did not increase but declined marginally as a share of national expenditure, from 2.3 per cent to 2.1 per cent; the budget estimate for FY 1974 put the proportion at approximately 2.8 per cent.[4] An alternate calculation from the figures presented in the annual *Budget of the United States Government* similarly suggests that between 1955 and 1970 federal expenditure for cash public assistance has remained generally stable at about three per cent of the total federal budget. By 1972 the actual federal outlays had declined somewhat below this figure, but they are projected to return to almost three per cent in 1974, as Washington assumes full responsibility for basic assistance to the aged, blind, and disabled.

A better perspective can be gained by viewing cash welfare payments in relation not to all expenditures but to federal spending for *income support* programs. An estimated total federal outlay of $4 billion for Aid for Dependent Children (1974), for example, can sound extraordinarily large—until it is juxtaposed with the $6 billion in new money devoted to a single year's (1973-74) increase in social security (OASDI) spending. When public assistance expenditure is examined in relation to total federal spending for *income security* programs (defined in the federal budget as OASDI, federal employee benefits, veterans' benefits, cash relief payments, unemployment insurance, Railroad Retirement, and other cash transfers), we find the following: In 1955 public assistance accounted for a quarter of federal income security programs, but the figure had declined to 16 per cent by 1960, to 14 per cent in 1965, 13 per cent in 1970, and 10 per cent in 1972. Schultze's figures show that as a proportion of all federal spending on income support programs —defined more broadly to include farm supports, student aid, and food stamps—the AFDC and cash assistance to adult categories have declined from 10 per cent in 1950 to an estimated 7.5 per cent

[4] Calculated from tables 6.1 and 1.3 in Schultze, et al., *Setting National Priorities, the 1973 Budget,* and tables 1.1 and 3.11 in *Setting National Priorities, the 1974 Budget.*

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for 1973. Depending on how one groups programs, direct income support accounts for between one fifth and two fifths of all federal budget outlays; but whatever the definition chosen, public assistance represents a declining share of these costs.

While absolute welfare costs have obviously increased, so too has the cost of government at every level. Examining not absolute growth but relative rates and shares reveals that *notions of an increasingly oppressive welfare burden wreaking havoc on the public purse are vastly overdrawn.* Those spending increases which have occurred scarcely suggest rampant, runaway growth. The budgetary share of cash relief has remained moderate, at least in the sense of being comparable to or lower than it was in earlier times. If public assistance is a fiscal burden, then in recent years there have grown up a great many equally or more burdensome public activities, few of which have commanded as much public comment or controversy. Control of all public expenditure is an important issue. The danger to sensible social policy arises when claims of a fiscal welfare crisis are used largely as a symbolic cover for the fact that some people would attach lower priority to welfare spending than others might care to.

Recipient rates

In addition to the conventional wisdom about the fiscal burden on federal, state, and city governments, we often hear the argument that America's welfare crisis is evident primarily in a phenomenal rise in recipient rates. The proportion of the general population in absolute poverty has declined, economic growth has continued, and yet relief rolls have climbed relentlessly. In 1971, seven per cent of Americans received cash relief payments, compared to four per cent in 1950. These figures also conceal marked regional disparities; for cities such as Boston and New York the rates may be as high as 15 or 16 per cent. To many observers, this paradox of growing dependency amid increasing affluence indicates a peculiar and dangerous flaw in American society, a breakdown in traditional social structures and personal independence.

Welfare rates have clearly risen in the United States in the last decade, and interpretations of the meaning of this increase will inevitably vary. Some regard this trend as benign, reflecting a greater willingness of society to aid the poor as best it can. Others view the increase as a social malady and assert that the receipt of welfare in itself produces a dependent state of mind, from which

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follow other perverse consequences, including illegitimacy, crime, and drug addiction. But whatever one's view, it is completely misleading to imagine that the fact and magnitude of growth in relief rates is unique to the United States. Relying on secondary sources then available, Nathan Glazer argued in an influential article entitled "The Limits of Social Policy" (*Commentary*, September 1971) that one reason Americans have, or consider that they have, a greater welfare problem than Sweden "is that, whereas in Sweden the proportion of those on welfare declines as other forms of social insurance broaden their coverage and become more effective, quite the opposite has happened here." In fact, a marked growth in welfare rates is exactly what has happened in Sweden since the mid-1960's. After remaining almost constant at or near four per cent for most of the post-War period, the proportion of Swedes on welfare rose steadily from 3.5 per cent in 1964 to 6.3 per cent in 1971. Far from being a problem of the most backward areas, as Glazer also suggested, this upward trend has been magnified in the largest Swedish cities. By 1971 the segment of the population on welfare had grown to 7.6 per cent in Stockholm, 8.7 per cent in Göteborg, 9.4 per cent in Malmö, and 10 to 15 per cent in some of the newly-built suburbs surrounding these towns. Despite sustained economic growth and concurrent improvements in housing benefits, social security, and other public income support, *Swedish welfare rates in 1971 were higher than they had been at any time in the preceding 23 years.*

A similar pattern has also occurred in another country that is often taken as a model welfare state, Great Britain. There the percentage of welfare recipients in the total population had already undergone a gradual rise from 3.9 per cent in 1950 to almost 5.5 per cent in the mid-1960's. Introduction of a reformed welfare program (renamed Supplementary Benefits) led to a spurt to 7.2 per cent in 1967, and since then the welfare rate has continued to grow, reaching 8.4 per cent of the population in 1972. We will not speculate here on the demographic and other factors that have produced this rapid rise. It is worth noting, however, that as in Sweden, this marked increase in recipient rates has occurred against a background of continuing improvements in comprehensive national insurance, health care, and other social policies. Daniel P. Moynihan has argued that in America "welfare dependency became a crisis in the mid-1960's *not* because it was consuming large amounts of money, or involved large numbers of people . . . [but] because of the rate at which the rolls commenced to grow." Yet the increases in British and Swedish rolls seem at least comparable to those in

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the United States and have brought with them little of the sense of impending social doom experienced in America.

International welfare comparisons bristle with technical and philosophical difficulties. In citing welfare rates of seven per cent in America, 6.3 per cent in Sweden, and 8.4 per cent in Britain, we do not mean to imply that the percentages can be mechanically translated as indicators of the degree of social dependency across nations. Indeed, the estimates in Sweden would be substantially higher were it not for the separation of means-tested housing allowances from the cash assistance program; in both the United States and Britain about one third of welfare costs are for the housing component of welfare recipients' household spending. Our argument is merely that the supposedly dramatic increase in welfare rates is not a uniquely American phenomenon. Whether or not program statistics are exactly equivalent, the point is that welfare rates within Britain and Sweden have shown a steady growth in the 1960's. Given the experience of these two countries, there apparently can be little assurance that expanding other forms of social assistance will stabilize, much less eliminate, the need for means-tested cash relief. (Nor have British and Swedish policy makers necessarily improved other programs with the aim of reducing welfare rolls.) On the other hand, the evidence also suggests that higher welfare rolls as such are not necessarily the sign of a peculiarly American social pathology, or of the special response to ghetto rioting, or of the perverse consequences of militancy among Community Action Programs or welfare rights organizers.

The sociology of single parenthood

In neither Britain nor Sweden is there complacency about welfare; attention is paid to rising costs and caseloads. Missing, however, are the clouds of articles and comment, the claims of doom and calls for wholesale reform that characterize the American policy debate. It is Americans alone who feel that they have been and are experiencing a major welfare crisis. Differences in the composition of our welfare caseload would seem an obvious explanation for the American preoccupation.[5] Yet upon a somewhat closer examination, the facts of U.S. composition turn out to be

[5] Other equally plausible explanations do, of course, exist—e.g., that Americans have a peculiar dislike for the dependent poor, or that British and Swedish social consciences have been demoralized into accepting social dependency. We leave such possibilities aside for want of factual evidence for or against these views.

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far from simple or straightforward. An inquiry into these complications provides instructive insights into American welfare policy.

Most observers seem more than a little vague about exactly why certain types of recipients should denote a more serious welfare problem than others. In suggesting that the problem abroad was less serious, Glazer argued that "in Sweden and England a high proportion of those requesting public assistance are the aged; in America the aged constitute a smaller proportion of the welfare population, and families a much larger share." Even if this were the case, there are probably few observers in either Britain or Sweden who would consider welfare a less serious problem because the aged rather than any other group were on relief. In fact, however, Glazer's proposition is only partially correct, and in any case, its implications are far from clear. In the United States in 1972, the aged constituted approximately 15 per cent of *all* welfare recipients. The Swedish aged (67 or older) were 11 per cent of all relief recipients in 1968. Moreover, the proportion of the Swedish aged on relief was, by the end of the 1960's, less than that of the general population. In Britain it is true that a higher proportion of welfare recipients (approximately 55 per cent in 1969) were aged, but this certainly has not led to any less discontent with welfare in Britain than in Sweden. If anything, the criticism and political rumblings have been and are greater in Britain, where the many aged on Supplementary Benefit are seen as indicating serious inadequacies in the pension system. While there has been a steadily growing political interest in welfare, the subject has been seized upon by reformers in search of a new grievance rather than, as in America, seen as a new menace threatening family structure and incentives to work. The incidence of aged welfare recipients provides no clear insight into the American welfare crisis; it merely leaves one wondering why, if one in 10 of our aged citizens—as compared with seven per cent of the general population—must rely on welfare, they are not considered a more serious problem.

We must now consider the families with children, and particularly fatherless families, who are on welfare. The reader who has followed us this far will perhaps be anticipating the denouement: America's distinctive welfare crisis arises from the dramatic increase in recipients under the Aid for Dependent Children program, which is held to reflect an increase in disintegrated, female-headed, often black families on welfare. But in reality the plot does not unfold so simply. America exaggerates its welfare component arising from one-parent families; there are foreign counterparts to the lone-parent phenome-

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non in U.S. welfare; and the substantial social needs that clearly do exist among such families are not a by-product of (or eradicable by) welfare program design. To understand these problems we must begin by disentangling methods of counting.

American welfare statistics

The United States is rather distinctive among developed nations in the way in which it creates welfare statistics. Whereas most nations report welfare figures which are in terms of, or reanalyzable into, actual family units, U.S. statistics (although counting both recipients and cases) tend to concentrate on the number of individuals within each type of program. American practice may make administrative sense in a system of federal/state categorical programs, but it bedevils any attempt to understand what is really happening to welfare families. It also considerably exaggerates the prominence of one-parent families.

In 1972 there were about 15 million Americans on welfare, and about 11 million of these, or 73 per cent, were *individual* recipients (i.e., children and adults) falling under AFDC. This AFDC recipient statistic, as we have seen, has certainly grown over time, and it is the one usually cited to demonstrate family disintegration and welfare crisis. The figure for *family units* on welfare is not readily available. Perhaps a reasonable guess is that, in all, about 5.5 to 6.0 million family units (i.e., households with and without children) are on all forms of cash welfare; this would represent a little under 10 per cent of the 67 million American families and unrelated individuals living in separate households. (Even this estimate may be exaggerated by the tendency to classify an aged couple living on welfare as two cases.) If we count children as dependents in a needy family, rather than as independent little citizens on welfare, there were three million families on AFDC (1972). But not all of these households are headed by single parents. Perhaps only three quarters are. One-parent families on AFDC in 1972 therefore accounted for 38 to 40 per cent of all households receiving some form of welfare payment. Some independent confirmation for this estimate is available. The five-year Michigan Longitudinal Survey of Income Dynamics suggests that in 1972 about 42 per cent of all family units on welfare were female-headed families with children. Old Age Assistance beneficiaries comprised 15 per cent of all individual welfare recipients, but a much larger share, perhaps almost one quarter, of all family units. By concentrating attention on individuals

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rather than households that receive benefits, the U.S. welfare debate has emphasized the prominence of welfare support for families with children.

Even if we are content to emphasize counts of individuals as the appropriate measure, AFDC can be a quite misleading indicator of the one-parent component in U.S. welfare. Based on HEW's January 1971 national survey of AFDC clients, it can be estimated that approximately one quarter of the program's 9.8 million recipients were not in one-parent families.[6] A large number, 1.7 million, were in two-parent family units where one of the adults was incapacitated, or (in 24 states) unemployed, or a stepfather. Another quarter of a million were in two-parent families where one of the spouses received one of the adult categories of welfare (i.e., aid to the blind, disabled, or aged). Over another 300,000 had no adult AFDC recipient present, a group often comprising institutionalized children.

If the above estimates of the one-parent family component in AFDC are close to being accurate, and if we include recipients of non-federally funded general assistance, then a reasonable estimate is that in 1971-72 approximately three fifths of the almost 14 million individual recipients in *all* cash relief programs were in fact in one-parent families. But in terms of family units rather than individuals, *probably about two fifths of all families on welfare were one-parent units.* Large though these proportions are, they do put in a more modest perspective the familiar cry that the welfare system in America is being swamped by a flood of disintegrated families.

But these adjustments are far from the end of the story. Lone parenthood is a multi-faceted phenomenon involving mothers who are widowed, divorced, separated (formally and informally), and unmarried, as well as a much smaller number of lone fathers with children. Critics who see in welfare a growing disintegration of traditional family values or social parasitism are presumably not referring to widows under AFDC, nor perhaps, and here opinions differ, to those who follow the well-established middle-class norm of divorce or legal separation. No, the sociological dangers of welfare are usually taken to be a function of the growing numbers of deserted, unmarried, and otherwise abandoned mothers. Our previous calculations can be supplemented from further HEW inquiries into the status of fathers in AFDC homes. Between 1961

[6] We are indebted to the staff of the National Center for Social Statistics, HEW, for aid in preparing these estimates.

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and 1971, the proportion of deserted, unmarried, and informally separated mothers did show some increase—from 48 per cent to 56 per cent of all AFDC families. Since one-parent families are assisted largely under AFDC rather than other welfare programs, probably *something like one third of all individual welfare recipients and a little less than one quarter of all family units on all categories of welfare in 1971 fell into these popularly worrisome groups of abandoned mothers.* Clearly such families and their needs are an important segment of the welfare problem, but they hardly constitute a major disaster in American public assistance.

The increase in single-parent households

Any attempt to use welfare and AFDC statistics for diagnosing social ills is further confounded by the causal intricacies of family and household formation. An increase in the number of one-parent, largely female-headed families can be due not only to growing marital and family instability—that is, the frequency of marital breakup—but also to some combination of 1) increases in the proportion of women becoming married, 2) increases in the proportion of women bearing at least one child, and 3) a greater tendency for the mother in a disrupted marriage to form a separate family unit rather than to live as a dependent in some other household. Thus total "one-parentness" in society need not be greatly increasing even though the number of such separate households may be growing. A recent insightful analysis by Phillips Cutright and John Scanzoni has suggested how this paradox has been occurring in America.[7]

Between 1940 and 1970 the number of white and non-white mothers heading households increased by about one million and one-half million respectively, in both cases an increase larger than the growth in the number of families. But the major part of these increases is attributable not to increasing marital instability but to the much greater tendency for such mothers to "go it alone" and head separate households. During the same 30-year period, the proportion of mothers (aged 15-44) in a disrupted marital status who were heading their own household almost doubled (to 77 per cent) for such white mothers and more than doubled (to 85 per cent) for such non-white mothers. For both whites and non-whites,

[7] Phillips Cutwright and John Scanzoni, "Trends in Marriage and the Family: The Effect of Past and Future Income Supplements," Indiana University, unpublished manuscript, May 1972.

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over four fifths of the increase in the number of previously-married female family heads has been due to increases in 1) their propensity to form separate households and 2) the numbers of women previously-married. The rest of the increase (15 per cent for white and 16 per cent for non-white mothers) has been due to greater marital instability and declining childlessness. Cutright and Scanzoni also show that there is little evidence that changes in AFDC benefits have increased this propensity to form separate households—a phenomenon under way among married couples and the aged as well as female family heads, among those with and those without access to government transfer payments. Thus the propensity for single parents to set up separate households rather than to live with parents or other relatives is not accounted for by higher or more stable sources of income. And even if welfare did increase the options of single parents to live alone, it is not self-evident that these are choices to which the individuals involved should have no right, or to which they should have a right only under extreme economic duress.

The sense of welfare crisis in America appears to be intimately bound up with questions of race and the image of abandoned black mothers. They are there and their problems are important. But blacks have scarcely been the moving force behind rising welfare rates. *During the decade in which America's sense of welfare crisis flowered (1961-1971), blacks as a proportion of all AFDC families changed very little, rising from 40 per cent to 43 per cent.* Non-white abandoned (unmarried, deserted, and informally separated) mothers constituted 30 per cent of all AFDC families in 1961, rose to 35 per cent by 1967, and in 1969 and 1971 remained fairly constant around 35 to 36 per cent.

In particular, black illegitimacy is an inappropriate club with which to beat the American welfare system. Cutright's study for the President's 1972 Population Commission showed that illegitimate children account for one third and legitimate children for two thirds of recent AFDC expenditure, that the doubled illegitimacy rate between 1940 and 1968 was affected more by the rise in white than in non-white illegitimacy rates, and that none of these higher rates were caused by either the level or changes in the level of AFDC benefits.[8] Moreover, three quarters of the increase in non-white illegitimacy was accounted for by improvements in health condi-

[8] Phillips Cutright, "Illegitimacy in the United States, 1920-1968," Commission on Population Growth and the American Future, *Research Reports*, Vol. 1 (Washington, Government Printing Office, 1972).

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tions that reduced the involuntary, malign controls formerly exerted by illness over gestation and conception.

Obviously these and other black mothers on welfare are conspicuously concentrated in urban areas, and no one should overlook the high welfare incidence among minority populations in certain cities, particularly New York—where many welfare critics live, work, and/or gather impressions. But neither should these observers translate their legitimate local welfare concerns into an indictment of American public assistance as a whole. A useful corrective to such over-generalizations is to recall that in 1971, unmarried, deserted, and informally separated non-white mothers probably made up only about 15 per cent of all family units on all categories of cash relief payments. The time may come when we reluctantly have to acknowledge that our malaise has been a crisis, not of welfare, but of prejudice toward single parents, non-whites, and especially anyone falling into both categories. In any event, if we knew more about welfare clients in terms of their actual family circumstances rather than the administrative groupings to which we assign them, it might be possible to view more temperately the place of non-white, one-parent families on welfare and their changing trends. As it is, *we know little more than that blacks and certain other minorities concentrated in several large cities are greatly overrepresented in AFDC, but that their overall proportions have remained fairly constant during the decade of America's supposed welfare crisis.* Perhaps the most astonishing thing in all this is that so many observers imagine that they can use official AFDC statistics to infer sociological facts and even socio-political theory concerning one-parent families, welfare, and America's uniqueness vis-à-vis other nations.

Some international comparisons

Yes, what about other nations? If the United States, by design or indirection, has acquired a welfare system that exaggerates the prominence of one-parent families, Britain's and Sweden's methods de-emphasize the same phenomenon. Table 3 presents our best rough estimates of the place of one-parent families in the population and welfare rolls of Britain, Sweden, and the United States.

Proportions of one-parent families to all families with children do not appear to differ greatly, and in many other developed nations about the same one in 10 ratio can be found. Certainly there are international differences in welfare composition. Our point is not

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TABLE 3. *Estimated Proportions of One-Parent Families in the General Population and on Welfare*

	BRITAIN (1971-72)	SWEDEN (1968-69)	UNITED STATES (1971-72)
One-parent families as a percentage of *all families* with dependent children	9%-10%	10%-12%	12%-13%
One-parent families and their children as a percentage of *all welfare recipients* (composition)	16%	24%	60%
One-parent families on welfare as a percentage of all one-parent families in the population (incidence)	37%-44%[1]	18%-20%	50%-55%

[1] Compared with Sweden and the U.S., British statistics demonstrate an unusually high (one in seven) proportion of motherless one-parent families. The 37 per cent figure applies to all one-parent British families; the 44 per cent refers to only female-headed one-parent families, and is more comparable to the other two nations.

to argue that all of America's welfare problems are a statistical artifact but to suggest that our situation should be seen in a more realistic and less idiosyncratic perspective. Our very rough estimate is that lone (i.e., widowed, divorced, separated, and unmarried) parents and their children accounted in 1971-72 for approximately 16 per cent of all welfare recipients in Britain, 60 per cent in the United States, and 24 per cent (1968) in Sweden. But before American policy analysts conclude that the British have achieved "success" in averting a welfare crisis of one-parent families, several inconvenient difficulties with this thesis should be pointed out.

The British public assistance program is, as we have seen, proportionately larger than Sweden's or America's and contains a relatively high proportion of aged recipients. Certainly it is possible that the aged, while accounting for more than two thirds of welfare claimants but less than one half of total expenditure for benefits, do provide some "protective coloration," aiding in the social acceptance of welfare by taxpayers and obscuring the position of socially less esteemed groups such as one-parent families. Still, the fact is that one-parent families constitute one of the fastest growing components of Britain's welfare population. Between 1960 and 1972 there was an approximately 70 per cent increase in the number of all persons on welfare but an over 200 per cent rise in the number of welfare recipients in one-parent families. The proportion of Britain's welfare clientele who were in one-parent families doubled from eight per cent to 16 per cent. Facts such as these have heavily influenced the work of the special government investigation (Finer Committee) that was

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launched in November 1969 to study the problems of British one-parent families. In comparison, the number of American AFDC families grew almost the same 200+ per cent between 1961 and 1972. Even relying on the gross AFDC figure, a comparative reading of welfare rate changes indicates little in the way of a distinctively American crisis. And as in America, statisticians puzzling over the British increase in single parents on welfare tend to conclude that the major explanations stem, not from large increases in the number of such parents in the general population, but more probably from the rising propensity of single parents to take up welfare benefits, to form separate households, and to find themselves uncompetitive in labor markets discriminating against females. In both nations a new sociology of single parenthood may be emerging.

If we are interested in the welfare involvement of one-parent families, a useful corrective for program differences is to examine not the components but the incidence of welfare—that is, the probability of being on relief among different population groups. Again the position of the United States does not appear to be unique. A reasonable estimate seems to be that in 1971 about one half of the approximately four million one-parent families in America were on welfare. In Britain the incidence for one-parent families was 37 per cent to 44 per cent and in Sweden about 19 per cent (1968). If incidence were a straightforward explanation of welfare crisis, British anxiety should approach that in the United States, which is not the case. If the actual one-parent family component in welfare were a decisive factor, Sweden should exhibit a sense of discontent with welfare greater than Britain's and closer to that in the United States, which is also not the case. What appears distinctive is not America's welfare phenomenon but Americans' response to it.

Welfare and work incentives

In addition to the high incidence of welfare among one-parent families, British resembles American experience in another respect. Public assistance (and its related family of poor law programs, such as Food Stamps, Medicaid, etc.) has tended to be regarded in America, as in Britain, as an exclusive rather than a supplementary source of income support. Swedish recipients, on the other hand, appear to be much more likely to combine relief payments with other forms of state aid. A special 1968 survey of welfare in Stockholm, where rates and costs are well above average, showed that only four per cent of one-parent families on relief (and excluding persons with social in-

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surance pensions, such as widows) had no significant income apart from relief. Welfare payments supplemented a variety of other income sources, such as earnings, sickness benefits, training grants, and public advances on private maintenance payments due to the child. For one-parent families on welfare, the proportion of income supplied by relief payments fell nationally from 44 per cent in 1959 to 39 per cent in 1968, and the proportion from other social benefits rose from 31 per cent to 40 per cent. By contrast, 60 per cent of all AFDC families in the United States had no income other than public assistance, and at the very most 13 per cent had cash income from other public benefits.

Related to the exclusivity of welfare support is the place of work and work incentives. Britain's low one-parent family component but high welfare incidence is consistent with the general expectation in public assistance that women with children need not work, a view traceable to the emergence of British welfare from the 1930's and early 1940's concept of relief to pensioners and dependents of the unemployed. Persons in full-time employment are excluded from welfare. American AFDC, growing out of a similar context with regard to the unemployability of widows and the aged, has 14 per cent of its welfare mothers in the labor force (8.3 per cent full-time workers), while in Britain only about eight per cent of lone mothers on welfare are working (all part-time). Sweden, with its relatively low incidence of welfare for one-parent families but higher (than Britain at least) fatherless family component, exhibits very high work frequencies; in 1965 over two thirds of all unmarried, divorced, and separated mothers with children under seven were economically active, and according to the 1968 Stockholm survey, 45 per cent of lone mothers on welfare (excluding pensioned widows) had income from employment. Yet with the marginal tax on earnings typically at 100 per cent within welfare alone (and disregarding other means-tested state programs), there is no work incentive formula to account for these high Swedish work rates. America, despite its ever lower de facto rates of marginal taxation on the earnings of welfare recipients, shows little sign of progress in persuading its welfare population to work. Clearly, the problem is a good deal more complex than deciding to redesign welfare programs, as the catch phrase of the 1960's went, for "work not welfare."

Observers in both Britain and Sweden perceive serious problems in their welfare programs. British worries about who gets welfare are in part concerned with misuse, but more prominent is the concern with underuse—the fact that those who are entitled may not be tak-

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ing up their benefits. One-parent families on welfare are an issue not because Britons worry about curtailing welfare roll growth, but because they worry about improving the economic position of such families. This may imply the need for changing existing public programs or creating new ones. Sweden has attained very high work participation. About one third of non-pensioner welfare cases have some form of gainful employment, and studies in new middle-class communities have suggested that in up to one fifth of welfare cases there are families whose heads are permanently employed with full-time wages. Precisely because of such facts, some Swedish observers have begun to worry that there may be developing a "new poor" with moderate earnings, narrow economic margins, and a legitimate need for wage supplementation. Whichever way a nation turns, welfare is not a problem that disappears.

The illusion of easy solutions

American social policy has contrived to present the worst of most possible worlds in welfare: high composition, high incidence, and high visibility, all of which lead to exaggerated notions of unique one-parent phenomena, family breakup, and welfare crisis. By tending to concentrate on individuals rather than families and on program beneficiary categories rather than actual household types, American policy, unlike British and Swedish, assures itself an unrealistic perspective on the place of one-parent families as a proportion of welfare households. By offering a substitute rather than a supplement to other forms of income support, American welfare facilitates high incidence and caseload composition for any particular group covered; more than in either Britain or Sweden, public welfare is, for most families with children, the first as well as last resort offered to those in need. By concentrating on categorical assistance applicable to only a few specified groups, American welfare ensures that any emerging social need among these covered groups is likely to appear critical and abnormal in relation to other more covert forms of social dependency, including dependency among the relatively affluent.[9]

Along most of its important dimensions—costs, rates, and composition—America's recent welfare experience is scarcely a unique crisis situation. The social implications for America of this experience have been vastly overstated. Phenomena of cost and rate increases,

[9] It requires little gift of prophecy, for example, to predict that one of the next "welfare crises" will be Aid to the Permanently and Totally Disabled. As AFDC

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of family support and special needs among one-parent families suggest neither runaway growth relative to other countries nor developments without their counterparts in other advanced industrial nations. What does appear distinctively American is not only the sense of crisis, but the delusion that by manipulating this or that program characteristic, particularly work incentive formulae and benefit levels, the underlying human needs will fundamentally change. If public policy could repeal social facts our problems would indeed be simple artifacts. Few nations exhibit the faith (perhaps a more accurate term would be *hubris*) that a neat, comprehensive plan of welfare reform is a way to "fix" society. For once, the use of language is correct: Americans presume that theirs is a crisis *in* but not *of* welfare. It revolves around program features, overuse of benefits as a result of pressure group activity, work incentives, work requirements, the venality of those poor who would cash in family relationships for relief payments—almost anything except welfare needs. Liberal democratic doctrine in America is caught in a dilemma: To relieve the economic distress of the poor creates a fundamental conflict with the competing goals of containing fiscal costs and promoting economic independence. There is no final solution in welfare because there are competing claims on the definition of a just policy.

The problem is intractable. No one in America, Britain, or Sweden knows how to eliminate underlying social phenomena like single parenthood by redesigning welfare or any other social program. We can, if we are willing to pay the price of a humane policy, mitigate the hardships and insecurities arising from problems of social adjustment. Policy can, if we wish, eliminate relief rolls at a stroke by recategorizing programs or abdicating all public responsibility; it can also exaggerate or otherwise distort events that are occurring on the relief rolls. No one, however, knows how to eliminate the many conditions precipitating economic needs which then find expression in the rolls. We do not know how to plan society. It is probably just as well.

When confronted with an intractable problem of conflicting aims and the reluctance to abandon cherished ideals, reformers can only hope to redefine the problem into terms that are at least susceptible to reasoned action. Of course the problems will not disappear, but

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growth has slackened, the fastest increases in rates have occurred in this Disabled category, which by 1971 passed one million recipients and became larger than General Assistance. One compositional clue is that by 1972 in New York City drug addicts accounted for 2.5 per cent of the caseload but 12.5 per cent of all transactions at welfare centers. By 1974 the federal government will have taken over not only adult welfare categories but also this latest crisis.

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we can perhaps cope with them better. More than enough attention has been given to strategies for "solving" the socal problems of economic dependency by simply curtailing welfare growth through administrative action to prevent people from getting on relief rolls and to move them off once they are on. Some strategies seek basically to change the characteristics of the single parent by work incentives or by servicing her out of social dependency; Nixon's Family Assistance Plan also would have hidden the one-parent family by extending welfare to include more acceptable groups, particularly the working poor with children. Another strategy would try to bypass the complexity of social needs and achieve a comprehensive solution through automatic calculations of tax credits, "Demogrants," NIT's (negative income tax), MIG's (minimum income guarantees), and a host of other similar schemes.

Reorienting the welfare debate

There is not space here to do more than assert the outlines of a more realistic reorientation of the welfare debate. The balance of attention must be shifted away from this or that comprehensive "solution" to problems in the welfare program and toward a consideration of the best mix of policies for addressing income insecurities in human lives. The American poor law should be broken up. Welfare needs to be redefined as more than a category of aid for isolated, dependent groups. Rather than hiding, or extending, or rehabilitating, or computerizing its categories of paupers, American welfare should strive to become a general residual facility available to any distressed citizen, and it should be interrelated with other forms of social support such as social security, retraining grants, housing assistance, health insurance, and effective enforcement of maintenance obligations toward the child. No one program can accommodate the differing and competing goals of adequacy, cost consciousness, work incentives, administrative exactitude, and full use of eligibility. Adequacy can be purchased only through complexity. Thus inconsistencies are inevitable. Improvements in other social programs or high work frequencies are no guarantee that relief rolls will decrease. The aim of social policy should be, not to divide people into programs, but to divide programs according to the needs that may arise at various times in any member of the community.

Obviously, there is more to the American social policy debate than statistical confusions in AFDC or lack of information on rela-

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tive fiscal costs and marginal changes in relief rates. Whether a nation senses it has a welfare crisis depends on a mixture of factual information, supposition, selective perception, and, ultimately, on the kind of society in which we wish to live. Some will emphasize the importance of constraints that preserve traditional structures, such as the family; others will always be predisposed to crusade for some emerging and unmet need. The crusaders will always be in business because no one knows to what extent each new policy response contributes to solutions or to the creation of new problems. Our own view is that it is insecurity and hopelessness which feed family breakup and social irresponsibility, that what is worth preserving of tradition springs less from economic constraints and fears and more from the possibilities for personal choice and hope. In the end, the limits of social policy are as narrow and as wide as the ambit of these hopes.

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The annual expenditure increment —or how Congress can regain control of the budget

AARON WILDAVSKY

WHY does a President whose administration is responsible for a deficit of over $30 billion in the last fiscal year suddenly appear as a protector of the purse? Why do Congressmen who vote for their share of spending increases express unhappiness with the collective results of their individual actions? How can a President get away with impounding funds when Congress has the power of the purse? The answer to all these questions is the same: because Congress is losing faith in its appropriations process. If Congressmen believed in what they were doing, they would support each other enough to get their way. The President prevails because secretly Congressmen think he is right. Since they do not believe in themselves, they espouse the heresy that it is the President who knows best.

It is true that the President is forcing the issue by insisting that he need not spend even after Congress passes bills over his vetoes. In this he should be beaten back. And no doubt innumerable ways will be found of tying his hands. But if the Congressional response is confined to that level, the same pattern will recur as soon as the issue leaves the headlines: Congressmen will again vote for appropriations one day and rely on the President to impound them the next. Feeling that the financial situation has got out of control, they will give the

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President far more of their power than he is capable of wresting from them. Yet the belief that the Presidency is a better institution to do budgeting than the Congress, that it somehow knows more or acts more rationally, is just what I said it was—a heresy. What is more, it is an illusion, created with mirrors; it is produced by sleight of hand or, to be more precise, by sleight of mind.

The magic of totals

Why does the President, who spends perhaps 20 hours a year on the annual budget, seem more rational than the Chairman of the House Appropriations Committee, who must spend 2,000 hours on it? It is simply because the former announces himself with trumpet blasts from on high, while the latter sounds more like the Tower of Babel than the Heavenly Chorus. The President's budget is made in private, the Congressional budget in public. Congressmen see how their budget is made; knowing what went into it they are, like sausage makers, leery of what will come out of it. Unaware of what has been going on in the Executive Office of the President, they respect its products more because they know the ingredients less. Thus have Congressmen come to prefer other people's errors to their own.

The magic is in the totals. If the President seems more rational, if he somehow appears to be in control and to know what he is doing, it is because he announces his desired totals of government spending with an air of conviction. Presidents naturally make up in assurance what they lack in knowledge. Although the Executive's total is not entirely plucked out of the air, neither is it turned out down to the last decimal by some infallible sausage machine of modern economic science. The total so authoritatively proclaimed by one man is in fact a product of the fair guesses and wild surmises of many within the executive branch.

What is in a total? On the expenditure side, it is a thing of shreds and tatters. Ability to project, or predict, federal expenditures is poor. Estimates can easily be off by $5 or $10 billion. Underspending usually runs a good two to three per cent, creating the possibility of an additional error of $4 to $6 billion. More than half of the total is left over from previous years in the form of unobligated balances, and no one is quite certain how large they are or how soon they will be liquidated. Aficionados of the craft also recognize that exactly what is included in the budget as an expenditure is, at the all-important margin, a matter of convenience rather than of necessity. Give me my way or give them theirs, and either of us will be able to make

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that budget larger or smaller by anything from $10 to $50 billion with just a flick of the projection or a twist of the definition.

But we are all Keynesians now, the trite phrase runs, from which we seem to conclude that an allowable total expenditure figure emerges from economic theory untouched by human hands. Keynesian doctrine is universally popular because the instructions it conveys—spend when underemployed, save when overemployed—are simple-minded enough for all of us to pretend we understand the economy. But the argument for impounding goes beyond this maxim by making the further suggestion that there is a direct and immediate connection between expenditures not made and the health of the economy. Yet spending changes, unlike variations in tax rates, make awkward tools for short-term economic management. In many cases no one knows what the employment or inflationary impact of an expenditure will be. It is quite possible for a short-term cut in authorization to lead to a middle-term increase in expenditure because closing costs have to be paid and permanent leave has to be given to workers that are laid off. By the time the effects of expenditure cuts are felt, the chances are that the economic circumstances at which they were aimed will have changed. No one can be certain that Presidential spending targets are correct for economic spending purposes; or, if they are, that the limits proposed will come near to meeting them; or, if they do, that the contrary effect will not occur. The totals are hunches, on top of guesses, wrapped in conjectures.

Because the President announces his preferred total only once, the impression grows that it is the total he has always had in mind. Nothing could be further from the truth. The most obvious feature of the Presidential total is never mentioned, no doubt because it appears self-evident: He announces it at the end—not the beginning—of his consideration of the budget. The total changes up to late December, when the government printer imposes the final deadline. True, there is a planning figure bandied about within the Office of Management and Budget (OMB) during the spring. This preliminary total is not necessarily devoid of meaning, but neither is it binding. Everyone knows it is subject to change, not only in response to events, but as the actual process of having to decide further reveals to the participants their preferences. In the last month, week, or day, the President must weigh his expenditure desires on, say, six to 10 major programs against the prospect of raising or lowering taxes within the context of the economic situation. If he changes his total a dozen times, only his Budget Director will know.

Just because the importance of budgetary totals has been exag-

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gerated does not mean that Congress should not be interested in them. If Congressmen will not think well of themselves (or outsiders think well of Congressmen) unless they come up with a total, then Congress must equip itself to produce the magic number. If many Americans, including Congressmen, believe that the nation is spending too much and want to return more purchasing power to individuals, that is another and better reason for being interested in the totals. Indeed, it is the widespread feeling that Congress is indifferent to the total that explains its vulnerability to Presidential impounding.

Imperfect budgets and negligent guardians

The last decade has revealed certain imperfections in the Congressional political arena. Members of Congress who vote for spending proposals find themselves unhappy with the resulting totals or the tax rates related to them. It appears undesirable either to turn down spending bids or to raise taxes to accommodate them. The President accuses Congress of wanting the credit for spending but not the blame for taxing. Impoundment is his challenging response: Either take the onus for raising taxes or allow me to make my limits stick by refusing to spend beyond them.

Power and responsibility go together: Irresponsibility equals impotence. Democratic legislatures are often enfeebled by making unreal decisions. When legislatures typically authorize several times the amount of expenditure that is available to the national treasury, as has been the case, for instance, in the Philippines, the actual allocation of money is necessarily transferred to the executive. The price of depriving no one is inability to indulge anyone.

In the past, Congress maintained the power of the purse because it played the role of guardian of the treasury. In most cases it cut requests the President made on behalf of the spending agencies. While Congress did not formally set a total, expenditures as a whole were kept within tacit boundaries acceptable to most legislators. Today guardianship still exists but it has declined. Congress still cuts more than it increases, but not by much nor with the regularity for which it was once (in)famous, and the appropriations subcommittees are more likely to try to hold the line at the President's request than they are to assume it will be cut.

If Congress goes all the way in abandoning guardianship, the show will still go on, but the President's men will act as guardians. The role of advocacy is already built into the system through the spending agencies. Congress cannot do better than the original cast in crying,

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"More, more!" Left unchecked, the agencies' desires would know few bounds. So there must be guardians. What is now being decided is whether Congress will continue to play the role of guardian effectively or will see another actor take over its role, and so its power.

The decline of guardianship as a Congressional role has been accompanied by the erosion of reciprocity as a Congressional norm. No large body of men can make as many decisions as an annual budget requires without breaking up into specialized groups and then deferring to the judgments of these groups. Reciprocity has been attacked from two separate directions with a single result—higher appropriations. The recommendations of appropriations subcommittees are being overturned on the floor more frequently than in the past, usually in order to increase the amount appropriated. Legislative committees have begun to rail against their opposite numbers on the appropriations side for exercising more power with less information, usually on the ground that expenditures should be greater than they are, even if that means getting around the annual appropriations process through direct (backdoor spending) or indirect (tax subsidies) access to the treasury. Being the adaptive creatures they are, the members of appropriations subcommittees have tried to reestablish the deference customarily shown to them by raising the price they are prepared to pay. Yet few like the total cost.

What is to be done? When we say that economic markets are imperfect, what we mean is that they do not produce essential information for buyers and sellers, with the result that optimal decisions are unlikely to be made. The solution is to "rig" the market by changing the rules governing permissible exchanges. When the budgetary process produces imperfections in the form of discrepancies between preferences on specific programs and the overall expenditure total, comparable steps have to be taken. Now it may be that rules which would make it easier to reconcile desired totals with programmatic preferences are the last thing Congressmen want to see, and will go the way of Thomas Edison's old scheme for instantaneous recording of votes. Maybe Congressmen do not wish to face the totals arising from individual spending actions. Perhaps they would rather avoid confrontation between desirable expenditures and unavoidable taxes. In that case, impounding would not be the abominable action of a pugnacious President but the routine undertaking of a conscientious Chief Executive. It would represent a systemic adaptation to the decline in Congressional guardianship. Congress would still be allowed to act as if it were budgeting, with the understanding that the President would cut back the total when he deemed that advisable.

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As a result, Congressmen would stand to lose not only the power over totals they conveniently wish to give up, but the power over spending they still wish to retain.

It is possible that the cries of outrage against impounding are merely the death rattles of a Congress inclined to self-destruction—possible, but hardly certain. There is nothing inevitable about what is happening. All the signs point to strong citizen concern over the decline of Congress. Many Congressmen are at least ambivalent enough to wish it were otherwise. Most Congressmen stand to lose the power that makes their job worth having; they should respond to proposals for maintaining that power. My own view is that it is both desirable and possible to maintain—and even enhance—the Congressional power of the purse. As evidence that different procedures are possible and that some actually work, let us consider the budgetary practices of France, Great Britain, and Japan in comparison to those of the United States.

Budgeting in the modern democracies

Because most of the budget is a product of previous decisions, the largest determining factor of the size and content of this year's budget is last year's budget. The budget is thus like an iceberg: By far the largest part of it is below the surface, outside the control of anyone. Long-range spending commitments have been made; this year's share is included as part of the annual budget. There are mandatory programs, such as veterans' pensions, whose expenses must be met. Powerful political support makes the inclusion of other activities inevitable. Budgeting, therefore, is incremental, not comprehensive. The beginning of wisdom about an agency budget is that it is almost never actively reviewed as a whole every year, in the sense of reconsidering the value of all existing programs as compared to all possible alternatives. Instead, it is based on last year's budget with special attention given to a narrow range of increases or decreases. *Thus the men who make the budget are concerned with relatively small increments to an existing base.*

The near-universal practice of incrementalism in budgeting has been attacked as mindless and irrational—mindless because most of the budget is not subject to scrutiny, and irrational because the full range of relevant comparisons is deliberately excluded from view. But mindless or not, incrementalism and other such devices to simplify and speed decisions are inevitable responses to the extraordinary complexity of resource allocation in governments of any size, a prob-

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lem that has gotten worse in recent decades as governmental expenditures have soared. With governments undertaking so many new programs and doing so much more under the rubric of old ones, there has been a greater emphasis upon simplifying calculations. More of the total budget has been taken for granted, and a lesser proportion of the changes has been subjected to the serious scrutiny of budget makers.

Incrementalism is becoming institutionalized in rich countries. Three out of the four countries for which information is available—Great Britain, France, and Japan—not only practice incrementalism but have built it into their formal machineries for making the annual budget. This is not incrementalism *sub rosa*, as in the United States, where it is adopted but not applauded, on the grounds that there must be something better, though no one can, for the moment, quite think of what that would be. Rather it is incrementalism with a clear conscience—indeed, with a vengeance. Tendencies to think and act incrementally are reinforced by procedures designed to compel incremental calculations.

Since 1955, France has used the device of the *service vote*, in which all past expenditure is considered a continuing commitment. Parliament votes only on additions or, occasionally, subtractions from past totals. What is more important, the Ministry of Finance treats past commitments as if they were inviolable.

Since 1965, Great Britain has replaced the traditional estimates of authorized expenditure with five-year projections of the cost of existing policies. Called by the name of the official committee supervising it, the Public Expenditure Survey Committee (PESC), the new procedure allocates funds in the form of annual white papers. PESC works. It has given the British Treasury considerably greater control than it had previously exercised over the growth of public expenditure. It is now far more difficult than it used to be to sneak in small items with large future expenditure implications. Containing the vices of its virtues, as most human mechanisms do, PESC also makes it correspondingly more difficult for old items to be taken out. To make sure that it has an ample margin of safety, the Treasury has adopted two new devices—the relative price effect and productive potential. Based on the (questionable) assumption that productivity in the public sector does not grow at the same rate as in the private sector, the "relative price effect" causes a proportion of each year's budget to be put away for use in case expenditures should go that much beyond expectations. "Productive potential" declares, by fiat, that productivity will increase at something under (or, now, over)

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three per cent, thereby building into the budget a small and constant margin for future increases. Thus PESC works within a margin of a margin with a safety factor added on.

Incrementalism is nowhere better practiced than in Japan. The Japanese can get incremental anyway you come at them, bottom-up, top-down, and seemingly sideways as well. To begin with, the Ministry of Finance imposes a 125 per cent ceiling over the previous year. A quarter of the previous year's budget might seem large were it not for the fact that past expenditures are not challenged at all, and it is expected that every ministry will get built-in increases amounting to at least half or more of the margin. Therefore, in making up its draft budget, the Finance Ministry adds both "Natural Increases" (cost-of-living and mandatory items) and "Semi-natural Increases" (those that are not required by law or by price increases but which every sensible man knows will have to be made). Should there be any question of whether one ministry is to be preferred over others in obtaining increases, the norm of balance *(baransu)* is applied so that comparable programs and categories receive essentially the same proportion of what there is to give. By the time Finance holds its own "Important Items" discussion, it is hardly necessary to think at all about its draft budget. Still, after all this, only a beginning has been made in performing the Japanese lamenectomy on the yearly budget. Concerned lest there still remain grievances unadjusted, the Ministry of Finance puts away a small percentage of the total so that all those who feel they have lost out in the original process can participate in what are variously called the "resurrection" (literally, to come back from the dead) or the "revival" negotiations. Within this rapidly diminishing margin, itself an increment of an increment, the Ministry of Finance allocates proportions across the board for salary and policy adjustment expenses, so that when top party officials and the Minister of Finance sit down for the final decisions, they are not overburdened with numerous hard choices.

The rise of the spenders

It is apparent that central budget control organs in Britain, France, and Japan have largely given up, or retreated from, detailed scrutiny of budgetary proposals. They no longer appear anxious to use the budget as a means of imposing their priorities on the rest of the government. What has happened? Why have they begun to abandon their ancient powers? What, if anything, have they got in return? The answer may be simply put: Finance ministries have trimmed

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their old expenditure powers in order to preserve their new authority over economic management.

As spending has risen, so have the spenders. Growing ever stronger from their past victories, feeding on popular desire for national grandeur or social justice, righteous in their wrath against those who would deny citizens the necessities of life, they have put their former controllers on the run. Threatened in Japan, for instance, by the Liberal Democratic Party, and elsewhere by the spending ministers (such as those who allegedly ganged up on the British Chancellor of the Exchequer in the 1950's), central control organs have had to reconsider their function. At the same time they have also been deeply affected by the Keynesian revolution in economic thought. Except in the United States, where the Office of Management and Budget is not a part of the same organization as the Treasury Department and the Council of Economic Advisers, the men who control expenditure are part of a larger apparatus whose tasks include economic management. As politician and civil servant alike have grown assured and comfortable with seemingly simple Keynesian decision rules, budgeters have increasingly identified their fortunes with their ability to manage the overall economic situation. One reason they have simplified their burden of calculation by confining their attention to increments to the budget is that their interest in total expenditures now far exceeds their concern with the specific programs that make up the total. Ministers of finance and their civil service advisers are usually selected not for their skill at cost-benefit analysis—which might be appropriate for choosing among expenditure projects—but for their ability to handle fiscal and monetary questions. The politicians's special interest in holding down or manipulating the tax rate is also served by the same macroeconomic approach. Hence an implicit bargain has been struck. Ministries of finance have begun to give up detailed financial scrutiny in return for control over the totals as an aid in economic management.

Though the United States has neither institutionalized incrementalism nor established the equivalent of a Ministry of Finance, there are signs it is moving in the direction of emphasizing totals in order to make expenditures the servant of economic management. What is revenue sharing, after all, but a means of centralizing totals and decentralizing priorities within these umbrella figures? What does the creation of a "super-secretary" in charge of economic affairs with an office near the President mean, but a desire to improve control over economic management? What, indeed, is the significance of recent changes in the Office of Management and Budget—the split between

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administration and budgeting and the exact parallelism between budget divisions and the policy spheres of the new domestic super-secretaries—other than a greater concern with totals and a lesser emphasis on what goes into them? For the budget arm of the OMB is being transformed into a group of staff assistants to the super-secretaries; their function will be like that of the old military division, which participated directly in drawing up the defense budget as an aid to the Secretary of Defense, except now there will be less need to pretend that they are backed by an independent controller in the person of the Director of the Budget. Who, then, will exercise budget control if the former controllers will not? Who will look beneath the totals to get at the composition of expenditures?

The change from interest in composition of expenditures to concern about their total amount has alleviated certain anxieties and created others. Now there need be less conflict between spending ministries and their financial controllers over who has the expertise in a particular line of policy. Having shored up their positions in this way, however, the central control organs have begun to worry that they might have gone too far, and that only those with an axe to grind are now paying attention to public policy. Conflict has been reduced, authority has been maintained, but the rationality of expenditures has been thrown into greater doubt than ever.

Of course I exaggerate. Budget controllers still exist, and they do on occasion attempt to interject their own ideas about public policy in internal ministerial allocations. But the rationale for such intervention has been seriously weakened by the growth of public-sector activity. The ministry of finance can always justify imposition of a total on the grounds that it is the expert on managing the economy and knows how much expenditure it does or does not require. Its budget arm, by contrast, can hardly claim the expertise to justify detailed control over the composition of expenditure. Traditional financial controllers have therefore become vulnerable to attack from outsiders who demand a share in budgetary decision making on the ground that they *do* possess knowledge going to the merits of the issues. The old boys have responded to these efforts to trespass on their preserve by sponsoring (or at least tolerating) their own reform: program budgeting.

The planners' challenge

The attack from the outside came from the planners. They claimed a comprehensive rationality that would enable them to determine

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where the nation should go and how it should get there for years ahead, with respect to both economic policy and the allocation of resources among sectors and within major projects. Finance ministries met the challenge by bolstering their capability in economic management and by mobilizing the political power to depart from the plans whenever they thought necessary, which was quite often. Whether it was because the planners in Japan failed to anticipate so much economic growth, or those in England so little, or the ones in France so much inflation, or because the central finance organs refused to implement the plans through the budget, in no case were planned targets met or even roughly approximated.

What matters here, however, is not the fate of the plan, but the nature of the conflict between finance and planning over expenditures. Planners are spenders. Their *raison d'etre* is economic growth. Typically they underestimate expenditures and overestimate revenues in order to create room for the investments they believe necessary to bring about growth. Thus planners are the natural allies of large spending departments, whose projects they believe desirable to promote economic growth. For this same reason, planners are also the natural enemies of financial controllers, who wish to place limits on expenditure and to preserve their authority to do so by maintaining their right to approve allocations within the total.

In Britain, the Department of Economic Affairs (DEA), and the National Economic Development Councils which preceded it, postulated high rates of economic growth. Although there was no theoretical rationale for doing so, spending departments and their allies found it convenient to assume that they could be allowed to grow with the rate of increase in gross national product. When economic growth fell below the announced figures, the Treasury found expenditures rising far more rapidly than incomes, creating balance-of-payments and inflationary difficulties. What the Treasury wanted, in these circumstances, was not a *lower* publicized rate of growth, but no announced rate of growth. It knew that politicians would not allow themselves to be accused of selling the country short, and that the figure would inevitably be higher than experience justified. So it fought the DEA and eventually secured its abolition.

In Japan, the Bureau of the Budget was not at all happy with the publication of planned expenditures years into the future, for it knew that spending ministries would use them as a floor from which they would try to get additional increments. The Budget Bureau insisted on treating the planned figures as maximums from which they were free to cut according to the conditions of the times as they interpreted them.

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Power and happiness, however, are not always equivalent. While it was not too difficult for the central finance organs to beat off attacks from the outside without making much change in their own activities, they did respond internally to their own dissatisfaction over the lack of intelligence that seemed to characterize their method of budgetary review.

The failure of PPBS

If the budget is meant merely to register the constellation of prevailing political forces, there is no need for any special budget review technique. It is sufficient if each actor plays his assigned role so that neither spenders nor guardians get their way entirely. But if there were a way of determining the merits of proposed expenditures that stood outside of the political process, central controllers would have a new rationale. They could better justify their own activity to themselves.

This was the promise of program budgeting. Instead of dealing with budgetary inputs, such as personnel and maintenance, for purposes of narrow control, the budget would be organized around categories emphasizing outputs, so as to improve choice. By providing quantitative indicators of inputs and outputs, and by ranking programs according to their merit as means of achieving these objectives, resource allocation would be done in a more rational way.

The main difference between the old and the new forms of budgeting was that one could be done and the other could not. The burden of calculation imposed by PPBS was literally beyond comprehension. Failing to create this simultaneous equation of society in the sky, understandably unable to come up with theories connecting inputs to outputs across the widest range of public policies, program budgeting everywhere fell of its own weight. While it is also true that there were significant bureaucratic objections from those who felt they benefited more under the old ways or who could not comprehend the new ones, and political objections from participants like American Congressmen, who looked at program budgeting as a sort of mumbo-jumbo designed to exclude them, nowhere was an ideal—or even a better—budget created. It was one thing to talk about focusing on future results, considering a wider range of alternatives, and generally getting better information, and something else actually to perform when no one could even remotely specify the required cognitive operations.

From the outset, the central budget agencies were ambivalent,

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divided functionally between the more traditional types and the program budgeters, who were themselves unsure of how far they could or should go. In Japan, for instance, program budgeting had to fit in with norms mandating equity among participants. If program budgeting could somehow be shown to be more scientific, so that its results were both more desirable and more acceptable, that would take care of the problem. But its sponsors had the usual trouble figuring out what to do and the usual difficulty in getting anyone who was disadvantaged to agree that what they did was good.

The federal government of the United States, which had first introduced program budgeting, was also the first to abandon it. Being initially the most ambitious, it experienced the most extreme difficulties in negotiating the pathways between knowledge and power. The OMB was able neither to produce information from program categories appropriate to the level of the user nor to impose such preferences as it did have upon the recalcitrant and unwilling. The spending agencies played along because they thought PPBS was for the OMB, whose favorable opinion was useful to them. When they discovered that the OMB was as much in the dark about what to do as they were, and that program budgeting was supposed to be for them, they used the program structures as the latest in the long series of devices for self-advertisement in the struggle for funds. It was a good two years after PPBS was disestablished, in the midst of a circular commenting on the reduction of unnecessary paperwork in the federal government, before the OMB finally began to receive inquiries from people who noticed something was missing.

The lesson of the British experience

Great Britain has been saved for last because the evolution of its thought and practice is most instructive. When all of the publicity surrounding program budgeting reached Britain, the Public Expenditure Group in the Treasury was well served by its customary caution. Observers sent to America came back enticed but wary of the innumerable pitfalls they faced. They proceeded pragmatically in two directions: They encouraged a few departments with interested personnel to try creating program structures and categories, and they gave part of the time of one of their bright young men to work with local government officials in actually introducing program budgeting at that level. Then they let them struggle. When neither group was able to advance because they could not figure out how

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to make the system work, the Treasury had no substantial investment to abandon.

Yet the Treasury could not sit still. Its own concern about the adequacy of program review was exceeded by that of the Conservative Party and its associated businessmen, who were anxious to give the Prime Minister and Cabinet more adequate tools for making expenditure decisions. Instead of rushing into program budgeting across the board, however, the Treasury persuaded the businessmen to join with them in creating a mechanism for Program Analysis and Review (PAR) that was aimed at encouraging departments to analyze a few major programs each year with the knowledge that they would be subject to Cabinet review. PAR is still in its infancy. It has hardly had time to make an impact, but it exists. Its viability may depend in part on whether another new apparatus, the Central Policy Review Staff (CPRS), which the Conservative businessmen designed to aid the Prime Minister and Cabinet in reviewing policy and adhering to party programs, will also be able to maintain itself in the heretofore closed world of top-level British political administration. Thus the Treasury now faces competition, not from planners with grandiose general schemes, but from analysts who are interested precisely in having an effect on the choice among major alternatives in the annual allocation of resources.

The very success of the Treasury in creating the PESC procedure for controlling expenditures has enabled others to concentrate on improving programmatic choices. Of the rich nations of the world, the British have in the Public Expenditure Survey Committee the only major innovation in budgeting practice that has proven successful. PESC does join knowledge and power. The Treasury does issue explicit instructions that departments can follow. Using the carrot of securing greater safety for vulnerable activities and the stick of its existing powers over expenditure, the Treasury has energetically sought and received substantial departmental cooperation. Departments and the Treasury sometimes agree to disagree, but they produce a five-year projection of existing expenditures that has become the actual mechanism for allocating resources in British government. *The lesson is not that successful budgetary innovation ends problems, but that it is based on making calculations manageable. The least demanding effort in terms of theory and data has had the greatest practical effect. And when the political question is asked—What is in it for us?—all participants, Treasury and departments alike, can find affirmative answers.*

In making recommendations for Congress, I shall draw on the

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lessons to be learned from other nations' budgetary practices, but there can be no thought of directly imitating them. Congress is not like the parliaments in these other countries: Congress is still powerful. Legislatures that actually exercise power independently of the executive over a wide range of activities have become a rarity in the contemporary world. Members of the Japanese Diet act on the budget not as members of the legislature, or even as adherents of the party in parliament, but by virtue of their association with the extra-parliamentary Liberal Democratic Party. Members of the House of Commons have little influence over expenditures in any capacity, and most of what little they do have comes from being back-benchers in the majority party. Deputies and Senators in France may trade on their extra-parliamentary positions as civil servants or mayors to importune for favors before the executive budget is made up. What is required to convince the executive to accede on one program or another is so involved that few try and fewer still succeed. It is important, then, that in appraising recommendations for change we take account of Congress's special characteristics.

Congressional realities

Past proposals to reform Congressional procedures for budget review failed because they did not take into sufficient account the realities of decision making under Congressional conditions. Whatever is recommended must be workable in a large, heterogeneous, and independent body of men who operate within an environment of fragmented and dispersed power. There is no sense in treating Congress as if it were, or even were led by, a small, cohesive group of men easily able to agree or to impose their will on others. To avoid these traps, it may be helpful to state the characteristics of the Congressional environment in the form of criteria for evaluating alternative budgetary procedures.

(1) *Many committees, not one.* If you have a committee that makes a budget which is not then altered by other committees—a committee without rivals, a steering committee of the legislature—it can be called a cabinet on the British model. Congress is a pluralistic institution; it has many centers of power, depending on the time and the issue. To be effective, Congress must exploit rather than fight against its dispersed, fragmented, and pluralistic nature. A good way to use pluralism is to embrace specialization.

(2) *More specialization, not less.* Without specialization, there is no knowledge, and without knowledge there is no power. When

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executives wish to emasculate legislatures, they break up existing committees and prevent formation of new ones that are specialized enough to look into specific areas of policy and small enough to act with dispatch. It is no good railing at last year's failures or the previous decade's disasters. Unless the legislature can keep up with the executive, it will become an auditor after the fact rather than the budgeter ahead of time.

(3) *Revitalize old committees rather than create new ones.* The budget must be passed every year. There is no time for a new committee to learn; it must perform well the first time or its activity will be held in disrepute. Old committees have the virtue of age; they have long been there and legislators expect them to be around. Because they perform other essential purposes (appropriations and finance), they can survive initial disappointments of failing to set a total or having it exceeded. Since they cannot compel other legislators to follow their lead, they also need the advantages of existing power levers. Putting the matter another way, it is too much to ask a new committee to take on a new function; in this case new wine will age better in old bottles. But will old committees be willing to learn new budgetary tricks? That depends on being able to answer the always relevant political question of incentives.

(4) *Something for all, not nothing for most.* If budgeting is a game, all players must have a chance to score. There has to be something in it for all—bureaucrats, executives, central control organs, legislators (where relevant)—or they will refuse to play seriously. Ministries could not enhance their control over totals, for instance, unless they were prepared to concede enhanced discretion over allocations within those amounts to spending departments and their ministers. The five-year PESC projections would not have worked unless the spending departments got enhanced security for vulnerable old programs as the price of lesser security for attractive new ones. So, too, the Congressional committees, the House and Senate as separate chambers, the leadership of both houses, the President, and the departments must all have something to gain from playing the expenditure game under new rules.

(5) *Representation, not bureaucratization.* Congressmen are chosen to provide representation. They are originators, purveyors, and mediators of preferences. Their preferences need to be open to live knowledge, not buried under layers of bureaucracy. Congressmen should not spend their time managing a legislative bureaucracy that is supposed to help them deal with the Presidential bureaucracy, which threatens to immobilize the Presidency under the guise of

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helping Presidents cope with the executive bureaucracy. The natural defensive posture of bureaucracies is to bury outsiders in mountains of paper. If legislators are also managers, and managers are bureaucrats, the advantages of differences in role are being lost. Better a lousy legislator than a beautiful bureaucrat.

(6) *Simplification, not mystification.* Rationality is supposed to mean effective action, not pretentious inaction. The rationality of results must prevail over the rationality of form. The rational man is not the one who makes believe he compares everything to everything else; the rational person is the one who manipulates the few variables under his control to good effect. If attention is focused on all or most possible relationships, it will be impossible to single out those most in need of change. However badly the Chief Executive confuses himself, he can always come out with a last-minute decision with a gloss of justification. If Congressmen confuse themselves, they will not be able to act at all. They need mechanisms to reduce the number of decisions up for consideration at any one time; they need ways of structuring a series of votes so that these are both meaningful and manageable. Before a legislature can act wisely, it must first be able to act. If Congressmen do not employ aids to calculation, they will be unable either to arrive at their own preferences or to settle their differences with others. Making calculations manageable lies at the heart of effective legislative decision making.

What should not be done

The critera for Congressional choice cut two ways: They help determine what should not be done as well as what might be attempted. To clear the way for my positive recommendations, let me begin by explaining why I have rejected a number of frequently proposed reforms.

(1) *The President should not be given power to make cuts from a Congressionally established ceiling through proportionate reductions.* This proposal would have the unfortunate effect of encouraging spending departments and appropriations subcommittees to inflate their recommendations so as to emerge with more after across-the-board cuts have been made. Moreover, this device creates the unfortunate impression that Congress is not able to handle its own affairs by disciplining itself. In the concluding section I shall try to show that Congress can convey a far more favorable impression by actually keeping budgetary outlays within boundaries it considers reasonable.

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(2) *Five-year projections of governmental expenditures should not be mandated for most programs.* A formal requirement to this effect already exists and produces no useful results. There is no need to create make-work in an already overburdened federal government. Such projections make sense only if the participants are willing to make commitments for that long a period. Experience with five-year projections under the British Public Expenditure Survey reveals that the spending departments get an implied commitment for continuation of expenditures on existing policies as the price of their cooperation. I do not believe that either the President or Congress is willing to go this far in reducing its already small degree of budgetary discretion, and I do not believe they should. The extreme incrementalism that results from the British procedure may not be desirable and, in any event, requires the existence of a central budget organ like the Treasury, which has the power to make commitments that will, for the most part, be followed by government. The essence of American government is that no one actor has (or is supposed to have) this authority.

(3) *We should also reject the variety of proposals calling for huge amounts of vaguely specified data on the theory that more data would somehow improve the budgetary process.* These requests range from pilot trials of each new proposal (thus guaranteeing that Congress would be unable to respond to emerging conditions) to cost-benefit analysis before (and evaluation after) the establishment of programs. Part of the difficulty here stems from the failure to distinguish between data—any bit that can be collected, ranging from laundry lists to telephone directories—and information, which is data collected according to a theory relating inputs to outputs, and means to ends, in a particular area of policy. Congress is already inundated with data; what it lacks and needs is information. Unfortunately, creativity is scarce throughout the country; theories telling us how to make effective decisions in education, welfare, and many other areas are hard to find. Congress might well support social research to provide such theories, but there is no point in requiring information that cannot be forthcoming without this knowledge. It is all too easy to suppose that if there were more data, there would be more understanding. But random data are not an aid but a barrier to informed decision. The most certain way for Congress to stultify itself is to collect more data than either it or anyone else can handle. As a general rule, no data should be produced unless there is a client who can specify the bit relevant to the particular theory related to the specific decision he is prepared to make.

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(4) *The numerous proposals calling for a joint committee on the budget are unwise.* The effect of the proposals would be to transfer Congressional power over the budget from the House Appropriations Committee to the joint committee staff without substantially benefiting Senators. Senators are few in number; their time and talents are necessarily spread thin. They readily command a wide audience, but they have trouble keeping up with the many subjects that come before them. So it is natural for them to rely more on staff work than do most Representatives, who have the time to specialize in the narrower jurisdictions that are their lot. The power of a member of the House Appropriations Committee is tied to his place on this committee far more than is the power of his opposite number in the Senate, who serves on numerous committees and whose role in securing public attention for issues and causes often absorbs a considerable part of his attention. A joint committee, then, would mean a further overshadowing of Representatives by Senators. It means giving Senators the benefit of the hard work done by Representatives, without corresponding return. It means that the Senators will use staff to counter the expertise of the House members. The voice may be the voice of the Senate, but the guiding hand will come from the staff.

The worst feature of the joint committee idea is how easily it slides over into a cabinet model without anyone quite realizing what has happened. The result, as the report of the Joint Study Committee on the Budget shows, is to replace an unsatisfactory executive budget bureaucracy with an even less desirable legislative bureaucracy. Their idea is that a committee in each house will fix a budget total, allocate amounts for major categories, and adjust taxes accordingly. Their critical assumption is that orders will go down and obedience will come up. That doesn't sound much like the Congress of our common despair and mutual affection—the Board of Estimate, maybe, or possibly even the Bundestag, but not Congress. Reforms that require Congress to be something other than it is or, worse, that would transform it into something not worth having, are somewhat less than compelling. The virtue of Congress is that its vices are exposed. Can't we keep our Congress and (some of) our money too? I think we can.

The annual expenditure increment

Despite all the difficulties, there *is* a way in which Congressmen can reconcile their desires on individual expenditures with their

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feelings about the total, and in which Congress can coordinate expenditures and revenues with the economic situation, even in the absence of a central leadership capable of compelling obedience. The procedure would work roughly like this: The President submits his budget. The small and capable staff of the Joint Committee on Internal Revenue Taxation makes its own estimates of income. A similar small staff is created on the expenditure side to estimate likely outlays and to check on what was actually spent in the past year. To these actual expenditures for each agency the expenditure staff adds an estimate of what is essentially a cost-of-living increase based on salary raises, price changes, and population movements. The starting figure of the appropriations process in the House of Representatives, then, would be made up of the previous year's expenditure plus an estimate of what it would take to keep the same activities going in the coming year.

This base expenditure would be calculated in total and for the agencies under the jurisdiction of the dozen or so appropriations subcommittees. They would hold hearings and report out bills as they do now, with the important proviso, which would have to be embedded in House rules, that the total could not exceed the previously determined base expenditure. Within that initial total, agencies could suggest changes and the subcommittees could reallocate as they wished. When the bill came to the floor, the members of the House would have the same rights and obligations; they could decrease the base expenditure or propose reallocations, but they could not move to increase it. A similar procedure would be followed in the Senate, which would have to reorganize its Finance subcommittees so that they corresponded to those of the House. The Senate could still serve as an appeals court in the sense of considering requests from agencies to have their monies raised to the base expenditure or to have a different allocation made. Once an appropriations bill was on the floor, Senate appropriations subcommittees and the Senators themselves would have to adopt rules forbidding increases above the base expenditures; the Conference Committee would be bound by the same rules. Thus both houses of Congress would, at this initial stage, concentrate essentially on how to do better what had been done before, or, no doubt less frequently, on whether what had been done ought to continue to be done at all.

Let us suppose that the annual expenditure increment would approximate three per cent of the total. Indeed, in the absence of compelling macroeconomic considerations to the contrary, a three per

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cent real increase in expenditures per year seems reasonable.[1] Something like three per cent would produce a yearly increase of approximately $8 to $10 billion as expenditures approach $300 billion. The key to my expenditure proposals lies in how this annual increment would be treated.

Just as the base expenditure budget is, in reality, a series of subcommittee budgets, the annual increment is meant to be a budget of the entire committee. Agencies would make their spending bids for a part of the annual increment. Each subcommittee would hold hearings and then make recommendations to the committee as a whole. No doubt the bids would add up to more than the available amount. The Appropriations Committee's task would be to establish an order of priority among them so that they could be made to fit within the total.

It is possible that the Appropriations Committee would become so convinced of the desirability of the spending proposals that it would wish to raise its working total. This should not necessarily be condemned. There is no reason for Congressmen to impose on themselves a task—fixing an inflexible total at the beginning of the budget process and sticking to it come what may—that no President could (or has even tried to) accomplish. Circumstances may change from the time the working total is established; the committee members may learn more about their own preferences in the process of considering each request. What they must then do is negotiate with the House Ways and Means Committee, through its leaders, for a new package of revenues and expenditures. The point is not that Congress should always stick to some arbitrary total, but that it should always act (and equally important, that it should appear to act) responsibly in relation to the nation's finances.

The annual increment would be reported as a single bill to the House of Representatives. The answer to the question of what the total should be would not appear in the form of some seemingly disembodied figure, but in the size and composition of the recommended increment. The total would equal the base plus the increment.

At this point I do not believe there should be a rule prohibiting increases in the increment. The House should be allowed to work its will. There seems little point in tying its hands because, when

[1] A case can be made for leaving expenditures out of short-term economic management, relying instead on taxes, money supply, and similar factors. But this paper already has a too heavy load to bear, and I will not now pursue the subject further.

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sufficiently determined, it will find a way to do what it wants. If the problem is that Congressmen believe they will act unwisely under pressure, the House itself may wish to adopt the suggestion of William Niskanen that increases above the annual increment automatically trigger tax increases.

The Senate Appropriations Committee would receive the annual increment and proceed to hold hearings on appeals to increase the total or to alter the composition of expenditures within it. Then the Senate as a whole would have the opportunity to alter the annual increment bill and the tax package with which it would be associated. The final total, as before, would be the increment that Congress actually votes added to the previous base.

Suppose legislators with a spending mentality deliberately estimate expenditures low and revenues high? Precisely this occurred under the legislative budget proposal after World War II and is a frequent practice of planning commissions in poor countries wishing to encourage higher levels of investment. Suppose legislators with a saving mentality estimate expenditures high and revenues low? It happens all the time in American cities and is practiced by finance ministries in poor countries around the world. People will learn to play any game. You can bring legislators in touch with procedures that will enable them to mix revenues and expenditures, but you can't force them to produce a brew you will like.

Why almost everyone stands to benefit

The effect of the annual expenditure increment would be to focus Congressional attention on important choices at the margin—a huge margin, it is true, but a margin of the total nonetheless. Having previously decided which existing programs it would like to rearrange and which it would like to do without, Congress would be choosing among new ventures and expansions of old ones. By a process of sequential reduction, through successive iterations, Congress would have refined its preferences on spending and related them to notions of desirable tax and economic policy.

Why should anyone want to do this? What's in it for them? What incentives are there for those participants in the budgetary process whose cooperation is essential if anything is to happen at all? Let us start with the House Committee on Appropriations. By dividing itself into subcommittees that are careful of each other's prerogatives, it not only gets the power that goes with expertise, but avoids the conflicts that come from some people minding other people's

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business. Yet minding other people's business is exactly what the committee members must do if the base expenditure and annual increment proposal is to have a chance. Why should they want to? Because by doing so they can maintain and even enhance their power as Congressmen. If they do not, they will lose their power to the President, who will be doing the real budgeting at the margins, which will force them into ruinous experiments with joint committees in which staff and Senate will nibble away at what little importance they have left. It is the old story again: "Harry, how's your wife?" "Compared to what?" he replies. The outcry over impounding is symptomatic of the general disintegration of the Congressional appropriations process. Compared to the alternatives, I think members will support a stronger voice for the entire Appropriations Committee.

The Senate is asked to choose between expanding its influence over an increasingly unimportant appropriations process through a joint committee with large staff, and being able to exercise more strategic control at the margin of the base expenditure and annual increment. Moreover, given the national prominence of economic management issues, and the natural interest of Senators in prominent national concerns, Senators would be able to use their positions on the Finance and Appropriations Committees and their role in relating revenues and expenditures to enter one of the most important realms of national policy. They would not be giving up any control over appropriations they could actually exercise, and would be gaining access to issues of broader national scope.

Spending agencies would enjoy the gain of increased stability in their existing programs through base expenditures, and suffer the cost of more tightly constrained competition for the annual increment. It seems like a fair exchange. Agency opinion will probably be divided: Some will want to protect what they have, while others will prefer to take the chance of getting more. Yet on balance I believe administrative agencies will find this procedure more helpful than not, especially since it guarantees that at least they will know about their base expenditure far earlier than is now the case.

Despite surface noise to the contrary, I do not believe that Presidents will find impounding a satisfactory way of life. It will give them greater power over the budget at the cost of enhanced responsibility for everything that happens. Since no one person can possibly do all the work involved, power would, in effect, be transferred to the White House staff and the OMB. And, indeed, there are signs of increasing Presidential interest in economic management and de-

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creasing interest in the details of expenditure. Why, otherwise, would the President increasingly relegate the solution of social problems to state and local governments? But in attempting to manage the economy, he will find that it is difficult to gather all the threads in his hands unless there is some body in each house of Congress that he can deal with on the same subject. The more Congress does to develop a mechanism for relating expenditure and revenue, the greater the input the President can make to it. Once the problem of the totals has been resolved, Chief Executives are unlikely to wish for detailed control over a $300 billion budget. If Congress agrees to take some of the heat, Presidents will find it both proper and necessary to make room in the kitchen and share their recipe for making the annual budget.

Now the Appropriations Committees are not the only committees that create expenditures. They control only 45 per cent of the total. True, these are the most flexible funds, but being less than half, they now bear a disproportionate share of the pressure when expenditures are thought to be too high. Clearly, the committees that cover revenue sharing, tax subsidies, price supports, housing loans, and the like—the committees that do their financing by the back door, so to speak—must play their part, and it is true that they will have less reason to support this proposal. The actor that has the least incentive is the Ways and Means Committee, which may find in its new power to agree on totals with Appropriations slender compensation for having to give others a voice in revenue sharing and tax subsidies. Yet even these Congressmen may come to see the advantage for them in the annual expenditure increment. They know that Congress lives or dies in its committees. If Congress loses power, this will happen because of its failure to work out appropriate relationships among its many committees. As is true for the rest of us, the harm others can do to Congress is vastly exceeded by the damage it can do to itself.

Regaining control of the budget

Imagine a legislature that actually exercises power in this world! Few people, including Congressmen, realize how rare a flower our Congress is. Many Americans, like myself, have a special affection for this exotic plant. But it does require special care. And if it is to survive, it must regain control over the budget.

If Congress is willing to accept the responsibility that goes with power, it can relate its preferences on expenditure with those on tax-

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ation and economic management. The trick is to break down the budget so that it can be handled by a large number of independent and diverse legislators who must coordinate their activities without central control. What has to be done is to take advantage of precisely those features of the Congressional system that are most characteristic: its independence, its diversity, its large size, its capacity for specialization, and its representation and brokerage of preferences. The annual expenditure increment is designed to accomplish this task. Congress first decides whether it wants to reallocate funds for existing programs in around a dozen major areas of policy. Then it relates the last $10 billion or so to its desire for new expenditures, together with its preferences on taxation. Congress thus has a chance to work its will; no more than this can be done.

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Economic Justice and the Economist

RICHARD A. POSNER

In a recent issue of *The Public Interest* (No. 31, Spring 1973), Lester Thurow, an economist at the Massachusetts Institute of Technology, argued that economic justice requires radical changes in the distribution of income and wealth in this country, and proposed specific redistributive measures. I shall argue three points here:

(1) The measures proposed by Thurow are highly questionable.

(2) There is no basis in economics for the concept of economic justice from which these measures are derived.

(3) The economist has an important role to play in a study and discussion of the distribution of income and wealth, but it is not the role that Thurow set for himself.

Thurow's specific proposals are as follows:

1. The federal minimum wage (now $1.60 an hour, with a number of exemptions) would be increased to $2.50 an hour, the level at which every fully employed worker would earn at least $5,000 a year. Presumably the exemptions in the present minimum wage law (for domestic workers, some farm workers, employees of very small businesses, and a few other groups) would be eliminated.

2. The federal government would offer employment at the minimum wage to anybody who wanted to work full time and could not find a job in the market.

3. A tax on "wealth and/or inheritance" would be imposed, designed to bring about the same distribution of wealth (i.e., property) as found in the earnings of white, male, fully employed workers. Thurow considers this distribution an appropriate "interim equity goal." The brackets and rates of the tax would be set so as to reduce the wealth of the wealthiest 14.5 per cent of American families, who according to Thurow now have between 60 and 70 per cent of the nation's wealth, to 28.5 per cent of that wealth, because this is the percentage of the annual earnings of white, male, fully employed workers that goes to the highest-paid 14.5 per cent of those workers.

These proposals would, if implemented, create costly dislocations in the economy, and in the society as a whole. As of April 1970, fully 43 per cent of all private non-farm, non-supervisory workers were earning less than $2.50 an hour, while the *median* wage of farm workers was much less than $2.50 an hour. A large number of studies

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of the employment effects of minimum wage laws have found, not surprisingly, that increases in the minimum wage cause unemployment.[1] And these were studies of much smaller increases than those proposed by Thurow. Moreover, the minimum wage law has always exempted the occupations in which the adverse effect on employment of imposing a minimum wage would be most serious. Thurow's proposal would eliminate these exemptions. One does not know just how many of the more than 20 million workers affected by the proposal would lose their jobs. But the number could be substantial—would almost surely be in the millions—and would be concentrated among the marginally employable, such as black teenagers and middle-aged women first entering the labor force; for we know from previous studies of the employment effects of the minimum wage that these groups are especially vulnerable.

Thurow, a labor economist, must know all this, which is presumably why he also proposes to require the federal government to offer jobs to all those who cannot find work. But he seems oblivious to the practical difficulties of implementing such a proposal. Once the Thurow proposal for a universally applicable $2.50 hourly minimum wage became effective, all sorts of people, all over the country (and especially in the South, where wages are lowest), would find themselves without work—farm workers, domestic help, dishwashers, sales clerks, soda jerks, delivery men, elevator operators, charwomen, restroom attendants, and so on. They, together with people able to obtain only part-time employment at the minimum wage, would present themselves to the nearest federal office and demand work. How would the government respond? It could buy and operate restaurants, grocery stores, fruitstands, home-maintenance services, and farms in order to be able to offer workers made jobless by the minimum wage (or unable to find full-time employment at that wage) the same kind of work that they had previously done, and in the same places. This seems a highly inefficient, indeed an impracticable alternative. Then again, the government could offer these people jobs as postmen, clerks in army commissaries, orderlies in Veterans Administration hospitals, and the like. This latter alternative—a massive expansion in distinctively "public-sector" jobs—seems to be what Thurow actually has in mind. All other objections aside, the huge costs of relocating large numbers of workers from private-sector to public-sector jobs, often in different localities, seem a decisive objection.

Alternatively, the government could simply pay the employers of workers now paid less than the statutory minimum the difference between their wage and the minimum; but this approach is also open to serious practical objection. The employer of such workers would have a powerful incentive to maintain wages at the lowest possible

[1] See, e.g., John M. Peterson and Charles T. Stewart, Jr., *Employment Effects of Minimum Wage Rates* (1969), and studies cited therein; Marvin Kosters and Finis Welch, "The Effects of Minimum Wages on the Distribution of Changes in Aggregate Employment," 62 *American Economic Review* 323 (1972).

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level (or even to reduce them) in order to maximize the government's subsidy of his labor costs. Clearly, he would never raise the wage of a worker whose competitive wage was lower than the statutory minimum, so the government's subsidy would rise over time as increases in general wage levels required increases in the statutory minimum. And the incentive for employers to upgrade the skills of their working force would be reduced, since if the market wage rate of the workers rose above the statutory minimum the employers would cease to receive any subsidy. The approach would assure the continued existence of a sizable class of marginal workers.

A related but more general criticism of Thurow's proposal is that it would reduce the incentive of marginal workers to improve their skills. The worker who today earns $3,000 a year has a strong incentive to upgrade his skills to the point where he can earn $5,000. Under Thurow's proposal he would have no such incentive, because his reward would be zero.

Thurow's proposal would have other consequences. Firms that employ workers at wages less than the proposed minimum would react by (1) increasing their wages, (2) discharging workers and either curtailing output or substituting capital for labor inputs, or (3) doing a little of each. Whichever course was followed, the cost of production would rise. At least part of the increase would be reflected in higher prices to consumers. And taxes would have to be raised in order to defray the costs to the federal government of employing all those made unemployable by the increase in, and extension of, the minimum wage.

At a guess, the wealth tax proposed by Professor Thurow would be even more dislocating. Assuming that the average size of wealthy families is not much different from the size of other families (actually it is slightly smaller), the 14.5 per cent wealthiest American families must comprise about 30 million people. Very few of them are really wealthy: A survey conducted in 1963 showed that, as of December 31, 1962, only 6.7 per cent of U.S. households had a net worth of $50,000 or more. In the $50,000-$99,000 bracket, where two thirds of these "wealthy families" fell, 23 per cent of the average family's net wealth was accounted for by home and automobile ownership.[2] Most such families are not what we have in mind when we speak of "the rich," yet all of them would be forced to surrender to the government 50 per cent of their net worth.[3]

A by-product of the tax would be a change in spending patterns.

[2] See Dorothy S. Projector and Gertrude S. Weiss, *Survey of Financial Characteristics of Consumers* (1966), pp. 151, 21.

[3] Thurow does not indicate how the burden of the wealth tax would be allocated among people subject to it, but he implies that it would be allocated evenly, since he indicates a concern with possible Constitutional objections to taking away more than half of a person's wealth. If the group as a whole must reduce its wealth by one half, and no member is to be forced to give up more than one half of his wealth, then obviously every member's wealth must be reduced by exactly one half.

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Since people would not be permitted to accumulate much money, they would have an incentive to substitute expenditures on consumption for savings. An extravagant style of living would be encouraged, and the apparent inequality of income and wealth thereby increased. To encourage extravagance by the rich seems an odd way to promote economic justice.

By labeling his tax a wealth "and/or inheritance" tax, Thurow implies that the desired redistribution of wealth could perhaps be accomplished by an inheritance tax alone. But even a 100 per cent inheritance tax would not achieve Thurow's purpose, since only a small fraction of the wealthiest 14.5 per cent of American families owe their wealth to inheritance. The Projector and Weiss study found that, even among families with $500,000 or more in wealth, only 34 per cent reported that inheritance accounted for a substantial portion of their wealth; for the $50,000-$99,000 bracket, the figure was only 12 per cent. A very steep inheritance tax would also create the undesirable incentive, just noted, to substitute consumption for savings. (A corollary is that the tax would yield little revenue.)

A striking feature of Professor Thurow's program is that it contains no provisions designed to benefit the millions of people who are incapable, for whatever reason, of full-time work. The program he proposes would actually make them worse off than they are now, since the higher minimum wage would, as mentioned earlier, increase the cost and hence prices of goods.

The subordination of the interests of the non-working poor and of consumers to the interests of workers, and the preoccupation with expropriating property, place Professor Thurow's proposals in the Marxist tradition. Marxists do not want to solve specific social problems; they want to turn society upside down. His proposals would do that. And these are only "interim" proposals!

THUROW's program of redistribution is offered as the fruit of an economic analysis of the problem of the just distribution of income and wealth. However, in presenting and justifying the program, Professor Thurow is not speaking as an economist, and his proposals have no support in economic theory.

The opening pages of his essay suggest that economic theory does not yield a definition of the just distribution of income and wealth. This is true, and might well have served to end the essay, since Thurow's professional competence is as an economist. But he does not stop there, because he regards the unwillingness of the economist to define the just distribution of wealth as both a source of reproach to the profession[4] and a "cop-out," since in his view economic analysis rests ultimately on postulates concerning just distribution. It does not.

[4] The essay begins, "Modern economics springs from the search for a definition of economic justice, but has largely abandoned that search." This is an eccentric definition of the springs of modern economics. Modern economics is rooted in the interest of Smith, Ricardo, Marshall, and others in the operation of economic markets.

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For example, when an economist says that monopoly is less "efficient" than competition, he means that the value of an industry's output, as measured by the willingness of consumers to pay for that output, is greater under a competitive than under a monopolistic organization of production, since a monopoly price will induce some consumers to substitute a product that costs society more to produce than the monopolized product. If you happen not to like the consumers who are hurt by the monopoly price--the product may be yachts and the consumers rich people—you may prefer the less efficient to the more efficient organization of yacht production. There is no inconsistency in having such a preference: "More efficient" is not a synonym for "better." Economics is a science of means; it does not prescribe ends. An economist who declares that efficiency should be the paramount value of society steps out of his professional role. Thurow is thus incorrect in saying that efficiency "ceases to have any meaning" unless certain "ethical" postulates such as "more is better" are accepted. Even if we were to stipulate that less is better, and the optimum output of the economic system zero, it would still be true that monopoly is inefficient because it reduces the value of output. Efficiency would still be a meaningful term, and its meaning would be, in fact, unchanged. To be sure, we might wish to define a new term, "efficiency$_1$," having the opposite property to efficiency: It would be maximized when the value of output was minimized, and vice versa. And we might be more interested in "efficiency$_1$" than in old-fashioned efficiency. Efficiency is a widely used criterion in discussions of public policy because most people still believe that the maximization of value is an important goal of society. But even if no one believed this, no part of economic theory would be invalidated as a result.

Thurow's deep confusion between facts and values is evidently responsible for such statements as that it is "necessary for a market economy to start with a 'just' distribution of economic resources," and that "there is no way to avoid the problem of specifying economic equity." Let us stipulate that the distribution of economic resources is unjust: The economic properties of the markets in which the unjustly endowed buyers and sellers meet would be unaffected. Of course we could not say that the outcomes of their interactions are "just," but it is not the economist's business to characterize the justice of various outcomes.

Although Thurow holds that economics cannot escape from having to grapple with the problem of the just distribution of wealth, he apparently thinks it proper for the economist, in grappling with the problem, to escape from economics. His definition of the just distribution of wealth owes little to economics but much to an unspecified mélange of public opinion polls, introspection, and political hunches.

The key to his analysis is the concept of "individual-societal preference." This is an individual's preference for how the wealth and income in the society should be divided up, and is to be distinguished from the individual's "personal-private preference," which deter-

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mines what goods he buys, where he works, and so on. The just distribution of income and wealth is determined by adding up people's individual-societal preferences. Unfortunately, this is difficult to do. An advantage of economic markets is that they enable preferences to be determined in a generally reliable manner. If I say that I prefer a cheap foreign import to an expensive American car, but then buy the latter, the purchase speaks louder than the words. Willingness to pay provides more credible evidence of preference than willingness to say. It also provides a means of weighting preferences by their intensity: Scarce goods are assigned to the people willing to pay the most for them. The ascertainment and weighting of preferences in the absence of markets is extraordinarily difficult. The democratic political process is the normal alternative in our society—and a growing literature documents its numerous and serious deficiencies as a method of revealing the preferences of the electorate. Its use in place of the market should be carefully circumscribed.

Professor Thurow does not identify the mechanism by which "individual-societal" preferences are authoritatively determined. We are left to infer his idea of the appropriate mechanism from such language as: "socially, we simply decide . . ."; "an act of social judgment"; "studies in this area indicate that individuals have a very strong feeling . . ."; "popular beliefs"; "many societies—including ours—seem to think . . ."; "my interpretation of our society's revealed preferences"; "a general perception." Formulations that personify society, such as "societies . . . seem to think," obscure the problem. It is precisely because society is *not* a sentient, articulate individual that "social choice," outside of economic markets, remains so elusive a concept.

It does not appear that Thurow looks to the democratic political process to reveal our individual-societal preferences. Plainly, the preferences revealed by that process are for a good deal less economic equality than Thurow believes just. Yet political feasibility is mentioned frequently. I note in this connection, unkindly, that Thurow was one of Senator McGovern's principal economic advisers in the 1972 Presidential campaign—not very good credentials for a political seer. The lesson Thurow draws from the 1972 campaign debacle is in any event a peculiar one: The voters were unwilling to support massive redistributions, by means of taxes and subsidies, to the nonworking poor; *therefore* they could be induced to support a more drastic redistribution of income and wealth accomplished through a combination of stiffer minimum wage laws and more extensive federal government employment with heavy wealth taxes. This view reflects a certain contempt for the thinking processes of American voters. Anyone who resents using taxes to support people who do not work should, as a matter of consistency, also resent using taxes to pay someone $5,000 a year for work worth only $1,000 or $2,000 in the market, and will view massive federal employment programs as boondoggles for the unproductive.

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Thurow's discussion of "wage contours" is relevant here. If it is true, as he says, that "different groups of workers expect . . . to have a fixed structure of wages with respect to other groups," then it follows that a sharp increase in the wages of the lowest-paid workers, as proposed by Thurow, would lead the next tier of workers to insist on a wage increase that would maintain the "historic differential" between their wages and those of the workers below them on the wage ladder. The demand for higher wages would travel upward through the entire ladder, leading to a general increase in prices, which in turn would require a further increase in the minimum wage, which then would kick off a new cycle of wage increases.

Thurow has also forgotten that Senator McGovern was forced by popular pressure to back off from proposing higher death taxes. The real lesson of the McGovern campaign is that most people do not believe that the distribution of income and wealth in this country is fundamentally unjust and they are unwilling to incur heavy costs to bring about a substantially more equal distribution. I think that Thurow realizes this, and that when he says "society thinks," he does not mean that his views would be supported in a public opinion poll or at the ballot box. Thurow must believe, rather, that our individual-societal preferences are authentically determined not by democratic political processes but by the opinion of an elite. Popular opinion is to be consulted only to assure that the goals of the elite are not so far in advance of popular opinion as to be wholly unattainable. The aim of his essay is to repackage the redistributive program of Senator McGovern in a form more palatable to the average person. But his approach can be effective only if the average person is easily deceived.

Because "society's" preference for massive redistribution rests ultimately on the views expressed by the small minority of educated and well-to-do people who dominate the Left in this country, it is important for Thurow to reassure the reader that there is no contradiction between wanting to maximize one's personal wealth (the usual personal-private preference) and wanting to have society changed in a way that will significantly reduce that wealth. The difference between a "personal-private" and an "individual-societal" preference is clear enough in principle. But I, at least, would have difficulty identifying the authentic preference of someone whose personal-private and individual-societal preferences were not merely distinct, but opposite and indeed mutually exclusive. Imagine an individual who is grasping, ungenerous, and ruthlessly acquisitive in his personal and business dealings but who, if asked, will say that he supports a restructuring of society that would result in a drastic reduction in his relative and absolute wealth and income. Does such a person *really* prefer an egalitarian society? Do not his actions speak louder than his words? Is it not likely either that he is a hypocrite or that deep down he believes that in the restructured society his wealth and income (not necessarily pecuniary) would be greater than they are now?

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Thurow's program rests on a weak foundation: the avowals, which only the credulous would take at face value, of a small and unrepresentative segment of the American people. He would be on firmer ground if he abandoned the pretense that his program is founded on people's preferences. He is telling people what they should think, not what they do think (which is again in the Marxist tradition). In any event his proposals owe nothing to economics.

THE two gravest weaknesses in Thurow's essay are ones that he shares with most proponents of redistributing income and wealth, and therefore deserve special attention. They are the failure to define economic equality correctly and the failure to weigh the costs of redistribution against its benefits.

Thurow assumes that the distribution of annual money incomes among household units constitutes a reasonable measure of economic equality. It does not. Consider first the problem of the intertemporal distribution of earnings. Two workers, a carpenter and a baseball player, have the same lifetime earnings, but the first has a steady income every year while the lifetime earnings of the second are bunched in a few years. In any given year the earnings of the two will be highly unequal; and in a table of annual earnings, they will contribute to an impression of inequality. But there is no meaningful inequality between them. A related point is that a table of annual earnings will include the earnings of a young worker just starting out and a worker in his prime. The earnings of the two will be highly unequal; yet again, their lifetime earnings may be identical.

Consider next the differential investment in human capital (earning capacity). A dentist has higher lifetime earnings than a plumber. But the dentist may have borrowed money to go to college and dentistry school, and the difference between his lifetime earnings and the plumber's may be merely equal to the amount required to repay the loans with interest, plus the dentist's forgone earnings while in college and dentistry school. Differential investment in human capital may explain much of the difference between male and female earnings. If most women prefer to remain at home while their children are young, it follows that they will spend less time in the work force than men. Their lower potential lifetime earnings will induce them to invest less in their earning capacity, so their annual earnings (which include repayment of, as well as return on, investment in human capital) will be lower. Their shorter time in the work force will also lead employers to invest less in training them, with similar results.

Another important factor is uncertainty of earnings, and taste for or against risk. Suppose that a successful inventor has an average income of $100,000 a year but only one out of ten inventors is successful (the rest have zero incomes from inventing). Then the average earnings of inventors will be only $10,000 a year and this is the correct figure to use in comparing inventors' incomes with those, say, of civil servants. Suppose, in addition, that people are "risk-averse," preferring the certainty of earning $10,000 a year, for example, to a

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10 per cent chance of earning $100,000 a year. If so, it will be necessary to compensate people for bearing risk. Society may have to pay successful inventors $150,000 a year before inventing becomes as attractive a career as civil service. The civil servant with his $10,000 income and the successful inventor with his $150,000 income will contribute to the statistical impression of economic inequality; in fact, their incomes are not unequal in any meaningful economic sense.

Still another very important factor is attitude toward deferred income. A high school graduate must choose between continuing in school, thereby deferring the production of income for several years, or beginning to work immediately. The additional education will enable him to obtain a higher income; but the additional income, as we saw earlier, is not pure gravy—it includes the repayment, with interest, of his investment (chiefly in the form of forgone earnings during the period of education) in earning capacity. If he attaches a very high time value to money—if a dollar today is worth much more to him than a dollar tomorrow—the return on such an investment may not compensate him for the present earnings that he will have to forgo. He will prefer to begin work immediately, even though his lifetime earnings will be lower. Income inequality is thus partly a matter of choice.

FINALLY, money income does not adequately measure real income. Consider two families, one where both husband and wife work and earn $10,000 each, and the other where only the husband works, and earns $10,000. The real income of the first family may be lower, not higher, than the real income of the second. The wife in the second family may be staying home because her services in the home are thought to be worth more than the income she would receive in a job outside the home. Suppose she could earn $12,000 in such a job. Then her services in the home (ignoring the tax advantages of nonmarket income) must be worth at least $12,000, making the family's real income $22,000. Or consider two construction workers, one of whom receives higher wages but has a more dangerous job. His higher wage is simply compensation for the higher expected accident costs in the more dangerous job, but it contributes to the statistical impression of economic inequality.

Income to the economist is a different concept from *monetary earnings*. It includes leisure and all sorts of other non-pecuniary yields from activity that are excluded in measures of pecuniary earnings, and it excludes repayment of human capital, compensation for risk, interest or deferred earnings, and other items that the statistical aggregates count as income. It is the economic concept of income that is relevant in appraising economic equality. The economic concept is poorly approximated by the kind of measure that Thurow uses.

Thurow treats the distribution of wealth as a measure of economic equality distinct from and coequal in importance to the distribution of income. This procedure would be defensible if he defined wealth properly, but he does not. A person's wealth is the present value of

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all of his future earnings, pecuniary and non-pecuniary (less the costs involved in the production of those earnings). The value of a home is the present value of its imputed rental income; the value of jewelry is the present value of the non-pecuniary income, in the form of pleasure, that the jewelry yields; the value of a share of stock is the present value of its expected dividends and capital gains. These forms of wealth are included in the statistics on which Thurow relies—but the most important is excluded: human capital or earning capacity. Were it included, the distribution of wealth would not be, as Thurow asserts, much more unequal than the distribution of income.

If income and wealth were correctly measured—as an economist would measure them—we could evaluate Thurow's premise that there is serious economic inequality among people who work. He has failed to establish this premise. And he considers only one type of cost associated with altering the distribution of income and wealth: the reduced incentive to work associated with heavy income taxes. He wholly ignores the costs of the redistributive measures that *he* proposes—the extension of the minimum wage, the expansion of public employment, and the tax on wealth. All of these are costly measures. His minimum wage proposal would, by raising the price of much labor far above market levels, reduce the efficiency with which labor is used in production. Employers would substitute methods of production that were cheaper to them, given the artificially high price of labor, but more costly to the society than the methods that had been displaced. Workers would be shifted from private-sector to government jobs, in which their labor would probably be less productive (otherwise the shift would presumably have taken place already). The heavy tax on wealth would induce costly adaptations designed to reduce its impact. It would also weaken the incentive to engage in various high-risk activities—such as starting new companies—that are economically feasible only because success is highly rewarded. True, the entrepreneurial role could be taken over by the government, but the experience of the Communist countries suggests that this would be highly inefficient.

The fact that the redistribution of income and wealth along the lines proposed by Thurow would have very high costs is not a decisive objection against his proposals. But in measuring those costs, Thurow would have contributed to an understanding of the issues involved in distributive policy.

THE last point suggests the essential failing of Thurow's essay. He has refused to respect the division of labor between economists and other students of society. Economics is a positive science. The economist has an important contribution to make to the debate over the appropriate distribution of income and wealth, but it is descriptive rather than normative. He can measure economic equality, or at least point out the limitations of the conventional indices; he can attempt to explain the real inequality that he finds; he can assess the distributive effects of various policies; and he can estimate the costs

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of various redistributive measures. Thurow does none of these things. He attempts instead to prescribe the just distribution; and this is a matter outside of his competence as an economist.

Finally, I am puzzled by the fact that nowhere in his essay does Thurow suggest a reason why a much greater equality of income and wealth would be a good thing for our society. He does not claim that society would be wealthier, or happier, or politically more stable as a result—and none of these conclusions is self-evident. He does not claim that the well-being of the people who would benefit from the redistribution is more important than that of the people who would lose from the redistribution. He takes for granted the desirability of redistributing income and wealth, and discusses only methods and tactics. While I have concentrated on what seem to me to be serious errors in his analysis, I am above all struck by his having ignored the fundamental question of what society would gain by achievement of his "interim" redistributive goals.

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A Reply

LESTER C. THUROW

WHAT distribution of economic resources constitutes a just distribution of economic resources? This is the question that I attempted to answer in my original article. My basic objection to Posner's reply is that it is completely negative. If he had stated why I was wrong in my analysis and then gone on to show how the problem of economic justice should be handled, I would have enjoyed responding. The interchange between a bright legal mind and an economic mind might even have led to some progress beyond that achieved in either of the original attempts.

Nowhere in his article does Posner say that the specification of economic justice is irrelevant or unimportant. He merely maintains that "there is no basis in economics for the concept of economic justice." He implies that the current market distribution of income is all right, but he is unwilling to argue that it constitutes economic justice. I have no objection to someone exercising his comparative advantage in negative thinking, but it should be pointed out that Posner provides no help in solving the basic problem.

To make this response more positive than his critique, I intend to lay down two ground rules for myself. First, I do not intend to respond in kind to the pejorative labels (Marxist, elitist, anti-democratic, and the like) that he throws around with great abandon. Second, I do not intend to hold him to his own view that individuals with professional degrees can write articles only in their own field. If I did, he would be disqualified from writing about economics. He argues that the concept of economic justice is "outside my competence as an economist," and thus I ought not to have written an article about it. I maintain that useful thoughts about economic justice are outside the competence of no one—be he lawyer or be he economist. The only relevant question is whether they are good thoughts. The pedigree of the author is interesting but ultimately irrelevant.

Since the first 22 pages of my article were devoted to analysis of the philosophical, psychological, sociological, and economic principles that have been advanced to specify economic justice, while the last three pages were devoted to actual public policies that seemed consistent with the previous discussion, I am going to return to that format and respond to his critique of the actual policies last. In my

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original article the policies were called "provocative" (they certainly provoked Posner), but they were not the heart of the article. Most of this response will be devoted, however, to analyzing the costs of shifting from the current distribution of economic resources to the one that I suggested—but first I must clear away some of the verbal underbrush.

Charge 1:

"*There is no basis in economics for the concept of economic justice.*" This contention is right, wrong, and irrelevant all at the same time. There is a large corpus of literature called welfare economics (discussed at some length in my article). In principle, social welfare functions could be used to make interpersonal comparisons and to specify economic justice. This large literature does not yield definitive deductive definitions of economic justice, but it does provide some interesting tools and insights into the problems. Paul Samuelson was given his Nobel prize partly for work in welfare economics. Kenneth Arrow was awarded his Nobel prize for his work on the difficulties of aggregating individual preferences to make social choices. Graduate schools of economics give courses in welfare economics. Posner might think that economics has nothing useful to say about economic justice and that economists have no right to think about it, but there are obviously many people who do not agree.

Moreover, his contention would be irrelevant even if it were true. We would still be left with the problem of specifying economic justice. If the answer lies outside of economics, then we have to search wherever the answer lies.

Certainly he is right that the answer does not lie entirely within economics. That is why I went outside my "professional competence." I discussed some of the philosophical, psychological, and sociological principles that have been advanced. I do not claim to have advanced degrees in all of these other fields (I do have one in philosophy), but this does not mean that I am barred from thinking about the implications of other intellectual findings on the problems of economic justice. My original article was an attempt to discuss a problem persuasively; it was not, either in content or in tone, an attempt to speak *ex cathedra* from superior professional competence.

As my original argument stated, fundamental value judgments are necessary to specify economic equity. If you are a follower of Rousseau and believe in the natural equality of man, then deviations from equality must be shown to be beneficial on some dimension. If you accept the position of classical political philosophy and believe in the natural inequality of man, then movements toward equality must be shown to be beneficial on some dimension. The article clearly stated that I took the Rousseauan position and went on to examine the various dimensions on which inequality could be justified as beneficial. I accepted many of these and did not advocate complete equality or even anything close to it. The article called for a distribution of economic resources (income and wealth) that was no more

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unequal than the distribution of earnings *currently* existing for adult white males—hardly a revolutionary equalization of incomes!

Charge 2:

"Thurow is thus incorrect in saying that efficiency 'ceases to have any meaning' unless certain 'ethical' postulates such as 'more is better' are accepted." While it is possible to define efficiency in such a manner that it does not depend upon ethical postulates, when it is defined in this manner it ceases to have any normative implications. There is no reason to want to be efficient. Let's take the Posner man who believes "that less is better and the optimum output of the economic system is zero." This man has no budget constraint. All economic goods have become free goods with zero price. There is no normative significance to wasting economic resources by being inefficient. One is wasting something with zero value. Efficiency can be defined as the condition that exists when the fewest possible resources are used to accomplish some task, but efficiency only has economic significance if there is a budget constraint in existence. The budget constraint leads one to want to be efficient. The Posner man has no need to be efficient, and thus an efficiency expert can tell him nothing of value. Economic advice on how to conserve zero-value assets has itself a zero price. Efficiency exists, but is valueless.

Charge 3:

"The democratic political process is the normal alternative [to the market] in our society—and a growing literature documents its numerous and serious deficiencies as a method of revealing the preferences of the electorate. Its use in place of the market should be carefully circumscribed." I will not comment on the irony of such a statement from a man who is busy accusing others of being anti-democratic. I am willing to join with Posner in swearing allegiance to market principles. Economic markets must, however, start out with something that is certified as a just distribution of economic resources if they are to yield desirable results. The distribution of economic resources is the distribution of economic votes in the marketplace. How are the economic votes to be distributed—that is the fundamental question. It is a question left unanswered by Posner, a question not answered by pledging allegiance to the market. A market economy that starts with an unjust distribution of economic resources will yield an unjust distribution of goods and services, regardless of its efficiency.

In my original article I discussed the possibility of allowing the market itself to determine economic justice. This would yield the marginal productivity distribution of economic resources, but Posner does not say whether he considers this to be a state of equity.

Charge 4:

"The difference between a 'personal-private' and an 'individual-societal' preference is clear enough in principle. But I, at least, would

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have difficulty identifying the authentic preference of someone whose personal-private and individual-societal preferences were not merely distinct, but opposite and indeed mutually exclusive." Posner makes an elementary error in logic here, since personal-private and individual-societal preferences can never be mutually exclusive. They exist in different domains. Individual-societal preferences concern the rules of the game; private-personal preferences concern the best way to play the existing game.

Since Posner says that he understands the distinction, I am afraid that the remaining problems lie in his own personal inadequacies. There is nothing inconsistent about an individual who advocates a 50 mph speed limit on the highways to reduce accidents and to conserve energy, yet still drives at the 70 mph legal limit. This driver knows that even more accidents are caused by cars driving at very different speeds, and that any gas savings on his part will simply lower the price of gasoline and cause someone else to use up the energy he saves by driving slowly. Similarly, a belief in communism is not a belief in the efficacy of personal poverty. There is nothing inconsistent about a communist who lives in a capitalist country and who acquires an unequal income. There is no way that he can acquire an equal income. He acts within the rules of the game in the society in which he lives, but he can still attempt to change the rules through the political process. If a person is willing to vote for substantial income redistribution, then he has revealed his individual-societal preferences on that issue.

Charge 5:

"Thurow assumes that the distribution of annual money incomes among household units constitutes a reasonable measure of economic equality. It does not." This statement is not true since I used both the distribution of money income (a distribution dominated by the distribution of earnings and human capital) and the distribution of physical wealth to represent the current distribution of economic resources. Both are necessary since unrealized capital gains are not included in the income series and since physical wealth, as well as income, represents potential control over economic resources. Since human capital cannot be sold, only rented, in a country prohibiting slavery, its earnings are appropriately added into the income series. To mix human capital and physical capital together is to add commodities that can be sold to a commodity that cannot be sold; the sum of these is hardly a meaningful measure of potential purchasing power.

Posner is evidently unable to live with the fact that the lowest fifth of all families have 5.5 per cent of total income and the highest fifth have 41.6 per cent of total income (as reported by the U.S. Census), or that the poorest 25.4 per cent of all families have *no* wealth while the top 18.7 per cent own 76.2 per cent of all private physical assets and the top 0.5 per cent own 25.8 per cent of all assets (as reported by the U.S. Federal Reserve Board; for the complete

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distributions, see page 77 of my original article). He argues that the distribution of psychic income (happiness?) is more equal than the distribution of money income or physical wealth.

Even if this were true, the distribution of happiness is not coterminous with the distribution of economic resources. Happiness is not spendable in those efficient economic markets. It does not command purchasable economic goods and services. Economic justice has to do with the appropriate distribution of economic resources vis-à-vis economic markets. Economic justice is not the same thing as justice without the adjective "economic."

Although Posner implies that his suggested corrections would lead to a more equal distribution of economic resources, they need not do so. His human capital correction has already been included in the distribution of income. There are no direct data with which to make his proposed lifetime income correction, but it is possible to get an idea of the difference that lifetime incomes would make by comparing, within a given category of the population, the distributions of income for particular age groups with the distribution of income for all members of the category. If lifetime incomes are more equally distributed than annual incomes, the distribution of income among particular age groups should be substantially more equal than the distribution of income for the category as a whole. Table 1 compares the distribution of income for males 45 to 54 years of age with the distribution of income for all males 25 years of age and over. As the data indicate, the distribution of income among males 45 to 54 years of age is actually a bit more unequal than that for all males. This suggests that an appropriate lifetime correction might make the distribution of income more *unequal* rather than more equal.

TABLE 1. *U.S. Distribution of Male Income (1971)*[1]

PROPORTION OF MALES BY INCOME	PER CENT OF MALE INCOME	
	ALL MALES 25 & OVER	MALES 45 TO 54
Lowest Fifth	4.8	4.2
Second Fifth	11.8	13.1
Third Fifth	17.8	17.6
Fourth Fifth	24.8	23.7
Highest Fifth	40.8	41.4

[1]Source: Bureau of the Census, *Current Population Reports*, Consumer Income, 1971, pp. 112, 113.

The need to promote risk-taking and investment (economic incentives) was extensively discussed in my article. It is one of the prime arguments for not moving to complete equality. I carefully reviewed the existing economic literature on the impact of highly progressive income taxes and transfer payments (see page 76). These studies indicated that a substantial degree of equalization could occur before running into the problems posed by Posner. The same types of empirical studies do not exist for the wealth tax since the United States does not have a direct wealth tax and since inheritance

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taxes have so many loopholes that they are not really operative. We know with certainty only that the part of the wealth tax affecting land has no incentive effects: Economic incentives don't create land.

We also know that you cannot predict the actual consequences of a system of taxation without empirical studies. This is particularly the case with income tax, for it engenders two opposite economic effects. The first of these is that high taxes lead to reduced incomes, which in turn induce greater work and investment in order to recoup and to achieve standard-of-living goals—the "income effect." But high taxes, by reducing net hourly earnings, also lead to more leisure and less work—the "substitution effect." Our actual experience with income taxes has been that, under a progressive rate structure up to 90 per cent, the income effect equals or exceeds the substitution effect. Inasmuch as the same two effects exist for wealth taxation, wealth taxes, like our income tax, may cause *more* work and investment rather than less.

Posner suggests that random risk or luck explains much of the dispersion in the distribution of income and wealth. Luck is one of those conveniently unmeasurable variables that you can maintain explains everything without having to worry about inconvenient data. I will note, however, that if luck does explain the dispersion in income and wealth, then taxes can cause a complete equalization of incomes without any cause for worry about economic incentives. The existing income differentials do not affect economic incentives since they are completely determined by luck—not economic effort.

Charge 6:

"*The proposals would, if implemented, create costly dislocations in the economy, and in the society as a whole.*" My proposals would reduce the dispersion in incomes and wealth by about 40 per cent. Somehow Posner thinks that if the economic lottery *now in place* for adult white males were expanded to everyone else, the economy would collapse. Since he is an adult white male, this is self-serving at the very least. Adult white males survive that distribution now, and I suspect that the whole economy could survive the same distribution. Economic markets are a lot more robust than Posner thinks; if they weren't they would have collapsed long ago.

We also know that free enterprise market economies can operate with such a distribution of income. If the distribution I suggest were in place, the U.S. distribution of income would be almost exactly that now existing in Japan. The world's fastest-growing free enterprise economy appears to survive such a distribution of income. There might even be a connection between Japan's higher rate of growth and its more equal distribution of income.

Let us look more closely at the $2.50 minimum wage that is supposed to cause such havoc. If Posner is right, he had better start heading for his economic bomb shelter since, as I write this reply, one house of Congress has already passed a $2.20 minimum wage. Empirical studies of the impact of the minimum wage do not agree, but

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let's examine the one referenced by Posner. This is a study by M. Kosters and F. Welch on "The Effects of Minimum Wages on the Distribution of Changes in Aggregate Employment" in the *American Economic Review* for June 1972. Since Posner presumably searched the economics literature for the study with the largest adverse impacts, we can take it as the outer limit of the possible effects. Let me quote from that study: "Our hypothesis is that minimum wages serve to reduce shares of normal employment and to increase shares of transitional employment for those groups of workers with low average productivity." Translated, this means that the minimum wage makes a low-productivity group more sensitive to cyclical fluctuations in employment (the business cycle), but that it does not stop the group from being fully employed if the economy is operated at full employment. Appropriate macroeconomic policies can offset the dislocations Posner fears according to his own favorite study of minimum wages.

But let's go on to the conclusions of this same study:

> For adults, the overall effect of increased minimum wages is to stabilize their employment. This increased stability occurs through shifting the incidence of employment fluctuations to teenagers, and the stabilizing effect is strongest for white adult males. It also appears that increased minimum wages may have stabilized employment for non-white adult males, although the effect is apparently very small and the statistical insignificance of the elasticities precludes any strong statements.

The last phrase means that the results have not been proven in accordance with the standard statistical tests of whether a hypothesis is valid. In other words, there is no hard statistical evidence that even these limited conclusions are valid. These are hardly the fearsome effects painted by Posner. In any case, to cover the possibility that the adverse effect on teenagers did exist, even though it cannot be statistically proven, I proposed the establishment of a public employment program.

Posner's economics of a wage subsidy is so bad that I am afraid that it would flunk an Economics I examination at any college in the country. He has completely forgotten the economic markets he likes so well. Take the case where a wage subsidy is paid to the employer of a low-income worker: In terms of the economist's standard supply and demand diagrams, this causes an upward shift to the employers' demand curve for labor (see Figure 1). The size of the shift is given by the wage subsidy. Employment rises, the new minimum wage is achieved, and the employers' payments fall somewhat, so that the subsidy must be larger than the increase in the minimum wage. But a limit to the employers' reduction in wages is set by supply and demand conditions—the more horizontal (elastic) the demand curve, the less the reduction in employer wage payments. The employer would have no volitional control over wages, as stated by Posner. His wages, as always, would be controlled by supply and demand. (The reader can work out for himself what happens when the subsidy is given to

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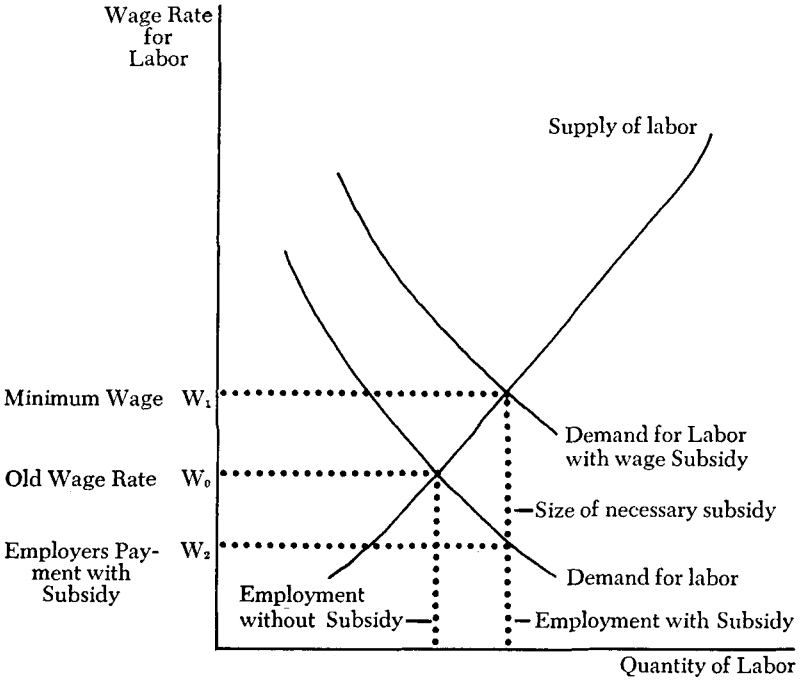
FIGURE 1. *The Economics of a Wage Subsidy*



the employee rather than to the employer. This causes an upward shift in the supply curve.)

In the mid-1960's the President's Commission on Automation issued a report going into great detail as to the productive things that a public employment program would do: Cleaner cities, more school assistants, and a host of other possibilities were listed. Anyone interested in a long discussion of public employment should look at that report. If Posner thinks that there is nothing productive to be done in our society, I am sorry for him.

My original proposals were carefully tailored to minimize economic dislocations. As this section indicates, the dislocations Posner prophesies are not apt to occur. They are not even substantiated by his own references.

Where does this leave the discussion of economic justice? It is for the reader to decide whether my original contentions still stand. But whatever that decision, it is clear that Posner has not improved our understanding of how to handle the problems surrounding the just distribution of economic resources. He hasn't even tried.

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The Poverty Lawyers

MUCH has been and will continue to be written about the question of class action litigation as practiced by poverty lawyers. Some of the issues are touched upon in Harry Brill's, "The Uses and Abuses of Legal Assistance," in issue No. 31 (Spring 1973) of *The Public Interest;* but Brill's article is so weakened by inaccuracies and omissions, and so malicious in tone, as to render it virtually worthless—except perhaps as a political document.

The article is based on Brill's experience as a research sociologist with the San Francisco Neighborhood Legal Assistance Foundation from early 1967 (a few months after the Foundation began operation) until the summer of 1968. As head of the Foundation during that period (I left in the fall of 1969), I would like to set the record straight.

Brill argues that class action litigation is not worth the time and effort expended on it because class suits produce no real gains for poor people. Furthermore, Brill contends that, because of its ineffectiveness, such litigation diverts resources from other more productive strategies, and leads to client abuse and attorney corruption. A strong indictment. Let's look at the facts.

In the two areas in which the Foundation concentrated its major suits —welfare and redevelopment—there were positive, concrete benefits for the poor. The evidence is incontrovertible. Contrary to Brill's contention that we won "extremely few" of our class action suits, in fact we won virtually every major welfare case brought by the Foundation while I was there. Between 1968 and 1973, largely because of a succession of highly effective lawsuits brought by the Foundation, the total number of California's welfare cases in the Aid for Dependent Children program (AFDC), the largest welfare program, more than doubled (from 208,000 to 428,000). The average grant per AFDC recipient increased by almost one third over the same period (from $48 to $63 a month). Moreover, by 1972 the *annual* cost to the State of California (i.e., benefit to our clients) resulting from just seven of the Foundation's many successful welfare cases was over $270 million! (This nearly equals the total federal contribution to all legal services programs since their inception.)

When Brill contends that the Foundation's successes in the welfare area were "hollow victories," and that the defeat of California's one-year residency requirement triggered austerity measures so severe that "the total number collecting welfare in California actually dropped," he simply doesn't know what he's talking about.

The Foundation has been equally effective in gaining tangible housing benefits for its clients in actions against the San Francisco Redevelopment Agency. First of all, the net loss in the stock of low-income housing in San Francisco resulting from *illegal* urban renewal policies was finally stopped by the federal court in the WACO (Western Addition Community Organization) case and later in the Yerba Buena case. Second, residents in the renewal areas, as a result of these decisions, became, through their community representatives, official participants in the renewal process. And finally, through a combination of court order and settlement in the Yerba Buena case, a minimum of 2,000 units of low-income

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housing is now to be built at a minimum cost of $40 million, and the design and management of the projects are to be in the hands of the community organization that is plaintiff in the suit.

Through some tortured logic, Brill contends that whatever was gained for the residents of the Western Addition in the way of concessions from the Redevelopment Agency came about precisely because WACO successfully resisted (for a time) efforts by Foundation attorneys to file suit against the Agency. The fact is that it was only *after* the federal court injunction that WACO gained the leverage it needed to force concessions from the Agency.

Not only was the Foundation's class action strategy effective in gaining results for clients, it also served in general to strengthen, not weaken, its community organization clients. What happened to WACO is probably the best example. Far from "jeopardizing the special goals and autonomy" of WACO, the favorable court decision breathed new life into the organization; WACO was at last able to establish a viable bargaining position with the Redevelopment Agency, and a new and broader-based coalition emerged in the Western Addition in which WACO played the central role.

This is not to say that relations between lawyers and community organizers were always supportive and amicable. There were many difficult times, particularly in the early days. Most of our mistakes were probably made in the first major class action suit the Foundation brought against the Housing Authority. Fortunately, we were able to learn from our mistakes; and interestingly enough, it was Brill himself who made this point in a memo to me dated May 26, 1967, two months after a particularly stormy session between Foundation attorneys and the Black Muslim leaders from the housing project: "I've really defined . . . the public housing case as my major responsibility. It provides an ideal occasion to illustrate how community organizations and the Foundation communicate, struggle, learn, and grow." It is difficult to reconcile this judgment with the charge leveled by Brill in his article that Foundation attorneys, in their zeal to sell "class action," engaged in systematic deception of community organizers, that they were "falsifying, distorting, and withholding information," and becoming in the process "cynical operators who paid little attention to the means they employed."

One of the strongest indications of the overall impact of class litigation is the very controversy it has generated and the relentless and determined efforts to restrict this type of litigation by such critics as Governor Reagan, Vice President Agnew, and President Nixon. It is curious to find Brill in such company and using many of the same arguments which these opponents have advanced. It is also curious that in his article Brill directly contradicts the views he held on class action litigation while working for the Foundation. At that time he was a strong proponent of the class action strategy and one of the principal supporters of an effective main office staff specializing in such cases. Brill not only supported the idea of class action litigation, but took great pains to convince some of the attorneys in the main office of the efficacy of such a strategy.

In a memo to me dated July 15, 1967, Brill indicated that one of his principal activities over the past month was "interpreting urban renewal issues to the [main office] legal department." He went on to note: " 'X' [a main office attorney] was not at all convinced at first that redevelopment should be stopped in Western Addition. It was only after countless hours of attending meetings with him, discussing the issues, etc., did we really begin to think of developing a case. And then we proceeded to translate our findings into legal issues. 'X' and I worked very closely together on this score." Brill played a major role in bringing WACO to the Foundation as a client in order to launch a major lawsuit against the Redevelopment Agency; he assisted in collecting data for the suit, helped in maintaining good relations between WACO and Foundation attorneys, and often referred to the WACO suits as "his baby."

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Why the dramatic reversal in attitude toward class action litigation? Why the glaring errors and omissions? Why the venom? And why did he wait *five years* to write the article? The timing may provide a clue. Is it mere coincidence that the article appears at precisely the moment when the Nixon-Agnew forces are out finally to emasculate the Legal Services Program?

—*Jerome E. Carlin*

Harry Brill replies:

My article on the San Francisco Neighborhood Legal Assistance Foundation is based upon material that I gathered first as its research director, and later, until the close of 1972, through contacts in the organization and the city, legal reports, and newspaper accounts. In June 1972, I interviewed key persons in San Francisco about the program. I also spoke then with Jerry Carlin about legal assistance and about a critical paper on the Foundation I had delivered one year earlier to the American Sociological Association—an advance copy of which I had sent him for his comments. So there is certainly nothing surprising about the appearance of my article or conspiratorial about its timing. For the sake of accuracy and fairness—I am persuaded that short-term evaluations are too frequently premature—my study purposely spans almost the entire organizational life of the program.

I wish I could have applauded the main office thrust toward class action. But I am convinced after careful scrutiny of its operation that the long-term accomplishments of its class action activities were most disappointing. I did not at all suggest that class action cannot be an effective tool on behalf of the poor; of course it can. I argued, however, that the various pulls upon the Foundation (and, I believe, upon many other legal assistance programs) promote approaches that only appear to assist the poor, but actually do not. My article represents an attempt to explore the main factors that seriously inhibit the organization from playing a more productive role.

The Foundation's track record on class action suits is quite poor. It lost most of these extremely expensive cases, which Carlin's strongly worded letter does not dispute; furthermore, a number of its legal victories were not enforced or were ineffective in bringing about change for other reasons. Poor clients would have been much better served if the resources expended in class action litigation had been channeled toward handling the more traditional individual cases, where the Foundation was highly successful.

Carlin's claims of the Foundation's success in welfare and redevelopment are both highly exaggerated and inaccurate. Though AFDC was liberalized in California during the 1960's, the Foundation certainly does not deserve the credit for the changes that occurred. Welfare rolls and benefits were increasing for a long while throughout the country because of many other factors: pressures set in motion by the civil rights movement; the increasing concentration of the poor and of blacks in Northern cities; the attempts to woo these groups politically, as part of the Democratic party's "Northern strategy"; and the impact of the poverty program, which provided the poor with an organizational vehicle (OEO's Community Action Program) that, together with welfare rights organizations, pressed, often militantly, for the liberalization of welfare.

Consequently, welfare was expanding in California for a good many years before the Foundation and many other legal assistance programs won any class action suits or even were in operation. The Republican administration, inheriting the social policies of its predecessors and a recalcitrant, federally financed anti-poverty organization devoted to welfare reforms, was in no position to stop or reverse the trend right away. But, particularly in California, the erosion has been going on for some time now.

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On this score, Carlin's allusion to the considerable rise in the number of AFDC welfare recipients from 1968 to 1973 is extremely misleading. For the current number of persons on AFDC, though higher than in 1968, is lower than it was in 1970. So after studying the official statistics on public assistance, I can only repeat that "the total number collecting welfare in California actually dropped."

The gains made from 1968 to 1970 were further eroded as a result of substantial cuts in other public assistance programs. Just from March to December of 1971, 176,000 Californians were removed from other welfare programs, including well over 100,000 families with unemployed fathers (AFDC-UF). Carlin makes the serious mistake, characteristic of class action poverty lawyers, of ignoring how one group of the poor is frequently penalized for improvements made by others—resulting in little or no net gains for the poor as a whole. This blind spot accounts, in part, for the very pronounced tendency of the Foundation to overrate its own operation. The truth is that the Foundation is unable to combat successfully the backlash against welfare, supported, so it seems, by a growing number of white working-class and middle-class citizens.

Take the following examples of how the Foundation readily mistakes its legal victories for actual gains. One of its successful cases resulted in a court order to the welfare department to increase the rent allotment of recipients. Though this would have netted recipients many millions of dollars, a fact the poverty lawyers proudly boasted about, the decision was never obeyed nor enforced. In another one of the Foundation's highly publicized cases, the court ordered the welfare department to increase benefits to recipients receiving other income. The state eventually responded by changing the relevant regulations. This either reduced or eliminated benefits for 500,000 recipients, costing them (as the Associated Press reported on April 13, 1972) $84 million annually, a sum substantially exceeding what the Foundation won in court. Though the Foundation avoids subtracting such losses from its achievements, the poor cannot avoid having them subtracted from their income.

Carlin is also mistaken on the redevelopment issue. First, I am surprised that he fails to acknowledge that the 2,000 or more units of housing promised the poor as a result of the Yerba Buena project are in jeopardy due to federal cutbacks and program suspensions. But even if these units were built, most of them would have to be shifted from other projects, and therefore they would not increase the net supply of housing available to the poor.

As for Carlin's insistence that the Foundation has been strengthening community organizations through its activities, this is nonsense. To repeat a major theme of my article, the Foundation co-opted one organization after another, and thereby effectively inhibited many of them from organizing around their political interests. In almost all instances, community organizers became subservient to the poverty lawyers, who had their own agenda.

So in response to Carlin's chiding me for changing my mind about the Foundation's activities, I very much regret that he and his colleagues have not changed theirs. Most of all, I hope the poor have learned some important lessons, one of which is that their penchant for relying upon professionals to determine their policies and strategies serves less to promote social change than to inhibit it.

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CURRENT READING

The International Appendix Index

West Germany clearly emerged as the leading country in an intriguing cross-national survey reported in *New Society* (May 3, 1973):

> Is there something special about the German appendix? It might seem so from the results of a recent survey conducted by the Institute of Epidemiology and Social Medicine in Hanover. Three times as many appendectomies are carried out in West Germany as in any other country, and the number of deaths from appendicitis is just as high. Furthermore, 33.7 per cent of West German men and an unbelievable 46.2 per cent of women are now without the organ. Professor Manfred Pflanz, director of the institute, compared the number of operations in Hanover with those carried out in Uppsala, Liverpool and the eastern seaboard of the United States. He then went a stage further and looked at appendectomies in East Germany and Austria. In the three German-speaking states, the rate of deaths from appendicitis is significantly higher than in any other European country; West Berlin, with 5.5 per 100,000, heads the table.
>
> Pflanz doubts if there is anything seriously different or inferior about the German appendix to trigger off such a campaign of violence. He suggests that it is more a matter of "a well-developed appendix-consciousness" among Germans. Just how many appendectomies are superfluous is unknown, not least because the number removed makes it impossible to investigate the proportion actually diseased. However, the five per cent sample examined in Hanover showed that only a quarter of those removed actually needed to be. There are fashions in medicine, Pflanz suggests, which can involve operations or other forms of treatment. In the 1930's, it was the United States that was gripped by an "appendectomy boom," which subsided once stricter medical controls were introduced. The number of deaths from appendicitis fell too.

Singing the Hours Away

The movement for a shorter working day, like most movements of social protest and reform, produced a large body of songs and poems. The ten-hour movement of the 1840's resulted in such songs as "Song of the Ten-Hour Workingmen," which was sung to the tune of "Auld

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Lang Syne." But it was the movement for the eight-hour day that produced the largest number of songs and poems. In the Fall 1972 issue of *Labor History,* Philip Foner reproduces the lyrics of more than a dozen of the most popular of these.

Two things are characteristic: their length (many have seven or eight verses interspersed with chorus) and their promise of the millennium once the goal has been achieved. The most popular of all the eight-hour songs, according to Foner, was one entitled simply "Eight Hours," written by I. G. Blanchard and scored by Reverend Jesse H. Jones, and published in the *Labor Standard* of July 21, 1878. It was, we are told, the most popular song in the labor movement before the appearance of "Solidarity Forever." Here is a typical verse and chorus:

The beasts that graze the hillside, and the birds that wander free,
In this life that God has meted have a better lot than we.
Oh! Hands and hearts are weary, and homes are heavy with dole;
If our life's to be filled with drudgery, what need of a human soul!
Shout, shout the lusty rally from shipyards, shop and mill,

Chorus

Eight hours for work, eight hours for rest, eight hours for what we will,
Eight hours for work, eight hours for rest, eight hours for what we will!

Another song, to the tune of "Marching Through Georgia," promised in the chorus:

Eight hours! eight hours! shall bring the jubilee;
Eight hours! eight hours! shall set the people free;
Less for daily drudging counts the more for you and me
Ring through the world the grand chorus.

The official imprimatur of the labor movement was given to the songs by the appearance in the *American Federationist* (the official magazine of the A.F. of L., edited at that time by Samuel Gompers) of the song, "Hip! Hip! for Eight Hours," by Edward O'Donnell. It was a song to make the capitalists shake in their boots. The first verse and chorus went as follows:

What tramp is that shaking our land in its sphere,
From the vain Massachusetts to 'Frisco's far plain;
And the lords of industry, why pause they in fear
While straining each neck to the swelling refrain?

Chorus

As fierce as the tempest, as fixed as the pole,
Despising obstruction and mocking earth's powers
The Toilers, oppressed long in body and soul,
In thunder tones take up the cry for eight hours.

Since the advent of the eight-hour day, there has not been any widespread movement among labor unions for a shorter working day. Recently, however, some groups have begun to demand a six-hour day (with eight hours' pay) for all workers. Al Furst, a young song writer-

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activist, has written the official "30 for 40" song of the Progressive Labor Party, one of the more radical factions of the New Left:

It's a 40 hour world, it's a 40 hour week,
And there are 40 hour cars on the 40 hour streets.
There are 40 hour clothes and 40 hour shoes,
Made by 40 hour workers with the 40 hour blues.

Chorus

But there's a new, there's a new place to go,
It's the 30 hour work week with the 40 hour payroll.

We want a 30 hour world, we want a 30 hour week,
We want 30 hour cars on the 30 hour streets.
We want a 30 hour sun and a 30 hour moon,
We want 30 hour flowers with a 30 hour bloom.

"Business as Usual"—Japanese Style

In recent years, American consumer advocates and other "socially-conscious" persons have sometimes attempted to use the annual stockholders' meeting as a forum for attacking irresponsible corporate practices. Though American critics of big business may not have achieved notable successes in this attempt, they have fared much better than their Japanese counterparts, as the following story in the *Japan Times* (June 4, 1973) indicates:

May is the month in which many Japanese corporations hold general meetings of shareholders. The most unusual aspect of these meetings was, paradoxically, the "business as usual" way in which they were conducted.

The paradox is that most meetings were finished in less than 30 minutes in perfectly orchestrated fashion despite the fact that most, or perhaps all, companies were subject to critical public scrutiny.

Most firms, as usual, hired men known as "sokaiya"—professional shareholders who control the proceedings of a shareholders' meeting by "effectively" (by force or threat of force) silencing any regular shareholders who want to criticize the management.

At the meeting called by a certain animal feed producer, whose executive had been arrested on a charge of rigging stock prices in collusion with a major brokerage house, sokaiya's shouts of "approval" drowned the mumbling voices of discontent over the perfunctory "apology" made by the president.

The meeting held by a maker of dairy products, which stood on trial for causing milk poisoning, also proceeded according to the order of business predetermined by the management and sokaiya.

Yes, the president apologized for the "trouble" but he—and other executives—were "protected" by those hired shareholders whose overbearing manner apparently silenced would-be critical shareholders.

Business went as usual also at the meetings of many other companies that came under fire recently for their antisocial practices—pollution, commodity speculation, bribery and the like.

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Covert relations between management and sokaiya are nothing new. No company president or chairman wants a turbulent meeting of shareholders. The quieter, the better.

But this desire to keep things quiet or cover up malfeasances gives the sokaiya a good excuse for blackmailing companies that have a guilty conscience. If a company has nothing to fear or nothing to conceal from its shareholders, there should be no need to hire sokaiya—estimated at over 1,500 by the Metropolitan Police Department.

Affluence in America, 1970

Summary data based on the 1970 Census, and recently released by the Census Bureau, present some interesting indicators of America's increasing affluence—and also of the pockets of poverty that persist in the midst of that affluence.

On Census Day 1970, about five out of six American households had at least one automobile available to them. Moreover, 29.5 per cent of all American households had two cars available to them, and 5.5 per cent had three or more. Among those households without automobiles, a considerable number apparently live in metropolitan areas with ample public transportation. This is reflected in the figures for New York State: It is presumably the heavy reliance on public transportation in New York City that accounts for the fact that the percentage of carless households in the state is over one third (or twice the national average).

The 1970 Census indicates that the same process of diffusion that has led to widespread automobile ownership may be taking place in regard to another item once regarded as a luxury—air-conditioning. In 1960 only 12.4 per cent of American homes were equipped with some degree of air-conditioning. By 1970 this figure had risen all the way to 35.8 per cent. And in many of those states with the hottest climates, well over half the homes had some air-conditioning. Texas and Florida led the nation in this statistic, with totals of 64 per cent and 61 per cent respectively.

Another item that has suddenly begun to be "democratized" is the second home. Though second homes (including vacation cottages, hunting cabins, and ski lodges, as well as single-family houses) are still a luxury enjoyed by less than five per cent of American households, the number of households with second homes rose dramatically from 1.6 million in 1967 to 2.9 million in 1970—an increase of more than 80 per cent in only three years.

But the 1970 figures also show that there are still a considerable number of American households that lack certain amenities taken for granted by most of our citizens. For example, there were 1.7 million American homes without any running water, and another 1.6 million with no hot running water. And 2.9 million housing units (or about four per cent) still relied on primitive means of sewage disposal. The great majority of these homes lacking modern plumbing facilities were in rural areas—a fact suggesting that our largely neglected rural

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population may be the group that has benefited least from the rising living standards of American society as a whole.

The Costs of Babel

The United Nations speaks with many tongues, and the solemn words of each delegate have to be recorded, translated, and transcribed. If one considers the expense of all this record-keeping, it is clear that each word costs its weight in gold. Here is an estimate of the costs of speaking at the UN, based on a survey made in 1968 and reported in *UNITAR News* (Vol. 4, No. 3, 1972):

> The *provisional* verbatim record of a meeting of two and one-half to three hours' duration averages 50-60 typewritten pages in the standard format. A meeting for which a direct verbatim record is taken in three languages, for instance, requires a team of 24 verbatim reporters and 27 typists. For a meeting covered by transcription from sound recordings to be provided in three languages, six translation "monitors" and 24 verbatim transcribers are required. A provisional summary record for a two-and-a-half hour meeting averages 15 pages. The team for one meeting a day in three languages would require seven translator précis-writers, nine typists and one and one-half revisers.
>
> The preparation of *final* verbatim records requires careful checking of the language version of the original speech and its rendering into the other languages. It is calculated that 20 meetings would give rise to, say, 1,000 pages of records in one language. . . .
>
> In 1971, 2,665 meetings were held at Headquarters alone, requiring 18,264 interpreter assignments. Out of these meetings, 376 were provided with verbatim records and 1,011 with summary records. The number of page units reproduced internally totaled more than 550,000,000. It is generally estimated that about 30 per cent of the entire workload of the United Nations is devoted to records.
>
> At 1968 prices and including the expenses of reproduction, the cost of documentation (according to document A/INF.124) would be:
>
> Provision of 10 pages of in-session documentation per day, for a session of three weeks, in four languages $13,500
> Provision of a verbatim record for one meeting in three languages, using the "immediate copy" procedure ..... $ 3,810
> Provision of a summary record for one meeting in three languages ..... $ 1,120
>
> The above figures are calculated costs of the *internal* translation, précis-writing, typing and reproductions services required. However, the translation costs involved in establishing the final texts of verbatim records have been estimated on the basis of *contractual* translation. They do not include editing, distribution or certain other operations involved, nor any overheads.
>
> In other words, assuming that the average length of a meeting in the General Assembly is about three hours, the cost of a 30-minute speech by a delegate comes to about $635 for a verbatim record, and to about $186 for a summary record (assuming it is recorded in three languages)!

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